

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY)	
)	
)	Docket No. 13-0318
Annual formula rate update and revenue)	
requirement reconciliation under)	
Section 16-108.5 of the Public Utilities Act)	

STATEMENT OF POSITION

OF

THE PEOPLE OF THE STATE OF ILLINOIS

The People of the State of Illinois
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TABLE OF CONTENTS

I. INTRODUCTION / STATEMENT OF THE CASE.....	1
A. Legal Standard	1
B. Procedural History.....	2
C. The Commission’s Investigation of ComEd’s Amended Formula Rate Tariff In Docket No. 13-0553.....	3
II. OVERALL REVENUE REQUIREMENT	
A. [YEAR] Initial Rate Year Revenue Requirement	
B. [YEAR] Reconciliation Adjustment	
C. ROE Collar	
D. [YEAR] Net Rate Year Revenue Requirement	
III. SCOPE OF PROCEEDING.....	4
A. Changes in the Structure or Protocols of the Performance-Based Formula Rate	
B. The Definition of Rate Year and the Reconciliation Cycle	
C. Original Cost Finding	
D. Issues Pending on Appeal	
IV. RATE BASE.....	6
A. Overview	
1. [YEAR] Reconciliation Rate Base	
2. [YEAR] Initial Rate Year Rate Base	
B. Potentially Uncontested Issues.....	6
1. Plant in Service	
a. Distribution Plant	
b. General and Intangible Plant.....	6
c. Functionalization / Use of W&S Allocator	
d. Plant Additions	
2. Materials & Supplies	
3. Construction Work In Progress	
4. Regulatory Assets and Liabilities	
5. Deferred Debits	
6. Other Deferred Charges	
7. Accumulated Provisions for Depreciation and Amortization	
8. Accumulated Miscellaneous Operating Provisions	
9. Asset Retirement Obligation	
10. Customer Advances	
11. Customer Deposits	
12. Other	
C. Potentially Contested Issues.....	6

1. Accumulated Deferred Income Taxes (ADIT) Adjustment on Vacation Pay.....	6
2. Cash Working Capital	
3. Other (including derivative adjustments)	
V. OPERATING EXPENSES.....	8
A. Overview	
B. Potentially Uncontested Issues	
1. Distribution O&M Expenses	
2. Customer-Related O&M Expenses	
3. Administrative and General Expense	
4. Charitable Contributions	
5. Chicago Forward Sponsorship	
6. Outside Services Employed	
7. Transmission Legal Fees	
8. 2012 Merger Expense	
9. Uncollectibles Expenses	
10. Advertising Expenses	
11. Sales and Marketing Expense	
12. Depreciation and Amortization Expense	
13. Regulatory Asset Amortization	
14. Operating Cost Management Efforts	
15. Storm Damage Repair Expense	
16. Interest Expense	
17. Lobbying Expense	
18. Gross Revenue Conversion Factor	
C. Potentially Contested Issues	
1. Rate Case Expenses.....	8
a. Appeal & Remand	
b. Attorneys	
c. Experts	
d. Other.....	8
2. Incentive Compensation Program Expenses.....	9
a. Long-Term Performance Share Awards Program (“LTPSAP”)....	9
b. Energy Efficiency/Rider EDA	
3. Employee Stock Purchase Plan (“ESPP”).....	11
a. Stock Price Issue.....	11
b. Income Tax Issue.....	13
4. Payroll taxes	
5. Pension Costs	
VI. RATE OF RETURN	
A. Overview	
B. Capital Structure	
C. Cost of Capital Components	

VII. RECONCILIATION.....	15
A. Overview	
B. Potential contested Issues.....	15
1. Deferred Income Taxes on Reconciliation Balance.....	151
2. WACC Gross-Up.....	24
VIII. ROE COLLAR.....	29
A. Overview.....	29
B. Potential contested Issues.....	29
1. Rate Base for ROE Collar Calculation.....	29
IX. REVENUES.....	33
A. Overview	
B. Potentially Uncontested Issues.....	33
1. Allocation of PORCB LPCs to Delivery Services	
2. Other Revenues	
3. Other	
C. Potentially Contested Issues.....	33
1. Late Payment Revenues related to Transmission.....	33
2. Billing Determinants	
3. Other	
X. COST OF SERVICE AND RATE DESIGN.....	36
A. Overview	
B. Potentially Uncontested Issues	
1. Embedded Cost of Service Study	
2. Distribution System Loss Factor Study	
3. Rider PE – Purchased Electricity	
C. Potentially Contested Issues.....	36
1. Billing Determinants.....	36
XI. OTHER	
A. Overview	
B. Potentially Uncontested Issues	
1. Staff Investigation into BSC	
2. Reporting Requirements	
a. EIMA Investments	
b. Reconciliation Year Plant Additions	
a. Contributions to energy low-income and support programs	
C. Potentially Contested Issues	
1. Use of Rate Formula Template / Traditional Schedules for Analysis of Adjustments / Disallowances	
XII. CONCLUSION.....	39

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The People of the State of Illinois, by and through Lisa Madigan, Attorney General of the State of Illinois (“the People” or “AG”), and pursuant to the request of the Administrative Law Judges, hereby file their Statement of Position in the above-captioned proceeding, consistent with the Initial Brief filed by the People on October 15, 2013.

I. INTRODUCTION / STATEMENT OF THE CASE

A. Legal Standard

The People argue that while the Electric Infrastructure Modernization Act (“EIMA”), 220 ILCS 5/16-108.5, enacted in October, 2011 and amended effective May 22, 2013 by Public Act 98-0015 established a process for annual, formula rate cases, it preserved the Commission authority to apply established standards for reviewing costs for prudence and reasonableness. The People note that EIMA provides that each “filing shall include relevant and necessary data and documentation for the applicable rate year that is consistent with the Commission’s rules applicable to a filing for a general increase in rates or any rules adopted by the Commission to implement this Section.” 220 ILCS 5/16-108.5(d)(3). Importantly, EIMA did *not* change the Commission’s authority to investigate and review a utility’s costs to assure that they are prudent and reasonable. The People cite Section 16-108.5(d), which authorizes the Commission to:

...enter upon a hearing concerning the *prudence and reasonableness of the costs incurred by the utility* to be recovered during the applicable rate year that are reflected in the inputs to the performance-based rate derived from the utility’s FERC Form 1....*The Commission shall apply the same evidentiary standards, including, but not limited to, those concerning the prudence and*

reasonableness of the costs incurred by the utility, in the hearing as it would apply in a hearing to review a filing for a general increase in rates under Article IX of this Act.

220 ILCS 5/16-108.5(d)(3)(emphasis added).

A finding of imprudence and unreasonableness must be based on substantial evidence, meaning "more than a mere scintilla; however, it does not have to rise to the level of a preponderance of the evidence. It is evidence that a reasoning mind would accept as sufficient to support a particular conclusion." *Commonwealth Edison Co. v. Illinois Commerce Commission*, 405 Ill.App.3d 389, 398 (2010) (internal quotations and citations omitted). Costs that are unnecessary to the provision of service, or that the utility has not justified in amount are not reasonable or prudent. *Id.* (employee costs related to the merger activities of the utility's parent not necessary to utility service, and the position that the employees worked on the merger for "free" was not credible).

B. Procedural History

In 2012, the Commission entered two formula rate orders relative to ComEd. The first, ICC Docket No. 11-0721, established the terms of the formula rate tariff under EIMA, and the Company's revenue requirements based on the historical FERC Form 1 filing for 2010 and projected plant additions for 2011.¹ In Docket No. 12-0321, the Commission established a new revenue requirement for ComEd that took effect on January 1, 2013 based on the Company's historical FERC Form 1 reports for 2011 and projected plant additions for 2012, and a reconciliation of the revenue requirement set in Docket 11-0721 with ComEd's actual costs for 2011.

In this docket, the Commission's final order will establish ComEd's revenue requirements based on the data reported in its historical FERC Form 1 filing for 2012 and projected plant additions for 2013, and a reconciliation of the revenue requirement set in Docket No. 12-0321 with ComEd's actual costs for 2012, subject to the ROE collar described in Section 16-108.5(c)(5).

The People point out that in this case, ComEd has requested an overall increase in revenues of \$353 million, which represents a whopping 17.6% increase over 2013 revenue requirements. This increase, shown on ComEd Ex. 14.01, page 2, Schedule FR A-1, is calculated by ComEd as follows:

¹ ICC Docket No. 11-0721, Order of May 24, 2012, Order on Rehearing of October 2, 2012. The May 29, 2011 Order was subject to rehearing on three issues, and the Order on Rehearing was issued on October 2, 2011. The Order on Rehearing established a new treatment for "pension asset," concluded that the reconciliation formula will use an average rate base in determining reconciliation capital costs, and approved the use of the short term interest rate to the reconciliation balance credit or charge.

	\$2,189 million	prospective revenue requirement for 2014 (line 23);
+	\$179 million	reconciliation of 2012 actual costs compared to the 2012 revenue requirement set in Docket No. 12-0321, plus interest (line 24);
--	\$7 million	collar adjustment of \$7 million (line 35)
	<hr/> \$2,362 million	<hr/> total net 2014 revenue requirement per ComEd (line 36) ²
--	\$2,009 million	2013 net revenue requirement (line 37)
	<hr/> \$353 million	<hr/> overall increase in revenues (line 38)

The People sponsored the testimony of utility accounting experts David J. Effron and Michael L. Brosch, who carefully reviewed ComEd's filings and recommended several rate base, operating income, return on equity collar and reconciliation balance adjustments needed to establish just and reasonable rates under Section 16-108.5(c) and the recently amended Section 16-108.5(k). The People assert that in order to establish rates that are just, reasonable and lawful under section 9-101 and 16-108.5 of the PUA, the People recommend downward adjustments to ComEd's claimed revenue requirement of *at least* \$42.8 million including three tariff changes being addressed both here and in the Commission's new investigation of ComEd's rates in Docket No. 13-0553, including . several adjustments to the adjustments for income tax expense, late payment charge revenues, incentive compensation expenses, and deferred taxes related to vacation pay, as well as a recognition in 2014 billing determinants of new business. The revenue requirements review conducted by AG witnesses Brosch and Effron, should be viewed as cumulative with the work and recommendations of Commission Staff witnesses.

On May 30, 2013, ComEd filed with the Commission revisions to Rate DSPP and the formula rate templates³ ("Revised Formula Rate Tariff") that were alleged to incorporate the changes in the law authorized by P.A. 98-0015. Six days later, the Commission approved the proposed formula rate template tariff and the rates established under the proposed tariff, and the new rates in question by this Complaint took effect on June 6, 2013. ICC Docket No. 13- 0386, Order of June 5, 2013. On May 31, 2013, ComEd filed a Verified Amended Petition to its April 29, 2013 Formula Rate Petition, which if implemented, "govern how the 2014 Rate Year Net Revenue Requirement, and (subject to future amendment) all subsequent revenue requirements under EIMA formula ratemaking, will be determined." ComEd Amended Petition, filed May 31, 2013, at 4.

The People assert that the formula rate schedules should be modified in three respects: the interest on the reconciliation balance should not be gross-up for taxes, the interest applied to the over- or under- collection indicated by the reconciliation should be net of income taxes, and the ROE collar should be calculated using average rather than year-end rate base.

C. The Commission's Investigation of ComEd's Amended Formula Rate Tariff In Docket No. 13-0553

² See ComEd Ex. 14.01, page 2, Schedule FR A-1.

³ ICC Docket No. 13-0386, *Commonwealth Edison Company - Implementation of Section 16-108.5(k) of the Public Utilities Act as it relates to the rates of Commonwealth Edison Company*, Order of June 5, 2013.

Two of the adjustments recommended by AG witnesses Brosch and Effron specifically challenge the Company's inclusion in its proposed revenue requirement of reconciliation interest and ROE collar adjustments not authorized by the recent EIMA amendments. Another adjustment proposed by the AG involves the proper application of interest to the "net-of-tax" reconciliation balance.

In Rebuttal testimony filed in this proceeding, ComEd claimed that these three proposed changes would require modification of the formula rate tariff itself, which they argue are prohibited under Section 16-108.5(d) of EIMA. While not conceding that point, the People filed a complaint with the Commission, Docket No. 13-0511, requesting that it investigate and modify the Revised Formula Rate Tariff filed by ComEd on May 30, 2013 in ICC Docket No. 13-0386 in response to P.A. 98-0015. The Complaint requests that the Commission open an investigation in order to (1) correct recent changes to ComEd's calculation of the Section 16-108.5(c)(5) return on equity ("ROE") collar computation and the Section 16-108.5(d)(1) interest on the reconciliation balance that were not authorized by law, (2) expressly reflect the appropriate tax treatment in calculating interest on the reconciliation balance in the formula rate tariff, and (3) establish just and reasonable rates pursuant to the formula modifications requested herein. ICC Docket No. 13-0511, AG Complaint at 1. In response to that Complaint, the Commission opened ICC Docket No. 13-0553 for the specific purpose of investigating these changes to the ComEd formula rate tariff revenue requirement approved on June 5, 2013. *See* Initiating Order of October 2, 2013. A schedule has been set in that docket, with a Commission Order expected before November 30, 2013⁴.

While these three issues may be resolved in Docket No. 13-0553, thereby impacting the rates that will take effect January 1, 2014, the instant docket also includes a full discussion of these issues in (1) the Direct and Rebuttal testimony of AG witnesses Brosch and Effron and, on some issues, other Staff and intervenor witness testimony; (2) the Rebuttal and Surrebuttal testimony of ComEd; and (3) the cross-examination of ComEd witness Christine Brinkman. For these reasons, the People will include in this Brief a full discussion of these issues for the Commission's consideration in this docket, as well as in the open 13-0553 docket. issues raised in the People's complaint. That docket is pending as Docket 13-0553.

III. SCOPE OF PROCEEDING

On May 22, 2013, P.A. 98-0015 became law and made specific formula rate tariff changes in subsections (c) and (d) of Section 16-108.5. These changes related to the Commission's calculation of the formula rate revenue requirement, including the annual reconciliation of revenues with actual costs incurred over the applicable rate year as follows:

⁴ To the extent that the Commission concludes that these three requested adjustments require modifications to the formula rate tariff, the People requested in the Complaint that the Commission make these modifications no less than 30 days before the entry of the January 1, 2014 rates to be set in Docket 13-0318. *See* 220 ILCS 5/16-108.5(c)(6) ("Any change ordered by the Commission shall be made at the same time new rates take effect ... provided that the new rates take effect no less than 30 days after the date on which the Commission issues an order adopting the change.")

- 16-108.5(c)(2) The formula shall reflect the utility's actual year-end capital structure for the applicable calendar year, excluding goodwill, subject to a determination of prudence and reasonableness consistent with Commission practice and law.
- 16-108.5(c)(4)(D) Investment return on pension assets described.
- 16-108.5(d)(1) Actual revenue requirement for the prior rate year determined using a year-end rate base;
- 16-108.5(d)(1) Interest on actual revenue requirement for the prior rate year calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior rate year;

New subsection (k), which set out the procedure for changing the utility's formula rate tariff to incorporate the changes made to subsections (c) and (d), specifies that the tariff changes resulting from the P.A. 98-0015 amendments "shall relate only to, and be consistent with, ... paragraph (2) of subsection (c) regarding year-end capital structure, subparagraph (D) of paragraph (4) of section (c) regarding pension assets, and subsection (d) regarding the reconciliation components related to year-end rate base and interest calculated at a rate equal to the utility's weighted average cost of capital." 220 ILCS 5/16-108.5(k).

New Section 16-108.5(k)(1) of the PUA provides "The Commission shall enter a final order approving such tariff changes and revised revenue requirement within 21 days after the participating utility's filing." 220 ILCS 5/16-108.5(k)(1). Six days after ComEd's filing, the Commission approved the proposed formula rate template tariff and the rates established under the proposed tariff, and the new rates in question by this Complaint took effect on June 6, 2013. Docket No. 13-0386, Order of June 5, 2013.

It is the People's position that ComEd's Verified Amended Petition to its original April 29, 2013 filing in this docket, filed on May 31, 2013, included changes to the formula rate tariff not authorized by P.A. 98-0015. While Section 16-108.5(d) does not authorize the Commission to include changes to the approved formula rate tariff in this proceeding, just what adjustments constitute changes to the tariff itself or are simply tariff inputs that the Commission can address in this proceeding remain at issue.

ComEd asserts in its Rebuttal testimony that the formula rate template approved by the Commission in Docket No. 13-0386 is the template currently in effect. ComEd Ex. 12.0 at 4. The Company also argues that changes to the approved formula rate template can never be made during an annual update filing/reconciliation proceeding such as this one, and that proposals inconsistent with the established formula rate templates must be rejected here. *Id.* at 6. The People assert that should the Commission agree with ComEd on those legal points, the Commission should adopt the AG-proposed modifications in its Order in Docket No. 13-0553. In the alternative, however, the Commission should adopt the AG-recommended changes to ComEd's calculation of (1) the reconciliation balance interest calculation; (2) the ROE collar

adjustment; and (3) determine the “net-of-tax” reconciliation balance to which interest is properly applied, in this docket, in order to establish just and reasonable customer rates.

IV. RATE BASE

A. Overview

1. [YEAR] Reconciliation Rate Base

2. [YEAR] Initial Rate Year Rate Base

B. Potentially Uncontested Issues

1. Plant in Service

a. Distribution Plant

b. General and Intangible Plant

In this docket, the Company urges the Commission to adopt its FERC methodologies of calculation. The People, on the other hand, continue to recommend that the Commission not change the G&A allocation methods that were recently reviewed and approved by the Commission. AG witness Brosch testified that the Company’s updated G&I Plant Facilities study generally complies with the approach approved by the Commission in Docket Nos. 11-0721 and 12-0321. AG Ex. 3.0 at 4.

The People note that the Company, apparently, recommends the use of W&S to allocate all G&I plant in this proceeding solely to preserve its argument that the Commission’s prior rulings on this issue were in error. ComEd IB at 16. The Company presents no further argument on this issue. Therefore, ComEd has not carried its burden on this issue and the People urge the Commission to adopt the well-reasoned arguments of the People and Staff on this issue. AG IB at 13; Staff IB at 11-12. The People urge the Commission to retain the allocation methods previously approved and applied by the Commission in previous formula rate orders.

c. Functionalization / Use of W&S Allocator

d. Plant Additions

2. Materials & Supplies

3. Construction Work In Progress

4. Regulatory Assets and Liabilities

5. Deferred Debits

6. Other Deferred Charges

7. Accumulated Provisions for Depreciation and Amortization

8. Accumulated Miscellaneous Operating Provisions

9. Asset Retirement Obligation

10. Customer Advances

11. Customer Deposits

12. Other

C. Contested Issues

1. Accumulated Deferred Income Taxes (ADIT) Adjustment on Vacation Pay

The People, through AG witness Effron, presented an adjustment of \$8,945,000 to rate base related to accrued vacation pay. The Company’s operating reserves, which represent

various accruals that have yet to be disbursed as cash, include accruals for vacation pay that was accrued but not used in the calendar year. The People recommend that the Commission deduct \$8,945,000 from rate base representing the net-of-ADIT vacation pay accruals that are held as operating reserves.⁵

The People note that the Commission has previously deducted vacation pay accruals from rate base, particularly in Dockets 11-0721, Order at 70; Docket 12-0001, Order at 59; and Docket 12-0293, Order at 12-13. In this docket, and in ComEd's last formula rate docket 12-0321, ComEd assigned some of its vacation pay liability to capital projects. While Mr. Effron did not challenge the amount assigned to capital projects, he testified that "this item does not require investor supplied funds and should not be explicitly included in the Company's rate base." Rather, the associated debit balance should be netted against the accrued vacation pay that is included in operating reserves." AG Ex. 2.0 at 5. Mr. Effron testified that ComEd's approach failed to properly account for the deferred taxes associated with the capitalized vacation pay accrual.

AG witness Effron stated that it was incorrect to simply add the capitalized vacation pay accrual to rate base because (1) the accrual did not represent investor funds and (2) that did not incorporate the effect of deferred taxes. To correct this, Mr. Effron eliminated the capitalized vacation accrual (a deferred debit) from rate base and instead offset the capitalized vacation accrual against the total accrued vacation pay included in operating reserves. AG Ex. 2.0, Schedule DJE-1. Mr. Effron then calculated the associated deferred taxes by multiplying the accrued vacation pay-- net of the capitalized vacation pay -- by the combined state and federal income tax rate of 41.175%. AG Ex. 2.0 at 4-5; AG Ex. 2.1. The People recommend that the Commission adopt the resulting vacation pay accrual adjustment, which is \$8,945,000 greater than the net rate base deduction calculated by the Company.

The People acknowledge that in Docket No. 12-0321, ComEd's first formula rate reconciliation filing, the AG and CUB proposed a similar adjustment to the Company's treatment of capitalized vacation pay accruals. Although the Commission declined to make the adjustment at that time, the Commission "encourage[d] the parties to make arguments that are clear and concise" and stated that it "hopes to see this issue further developed in subsequent rate cases." Docket No. 12-0321, Order at 17 (December 19, 2012).

In this docket, the People emphasized that Mr. Effron agrees that the rate base deduction for accrued vacation pay should be reduced by the amount of the capitalized vacation pay accrual recorded as a deferred debit. However, Mr. Effron testified that this deferred debit does not require investor supplied funds because vacation pay accruals result from ratepayer revenues that are "accrued" due to the delay between when the vacation pay is earned and when it is used. Therefore, the capitalized vacation pay accruals should not be included in the Company's rate base. AG Ex. 2.0 at 5. Nevertheless, Mr. Effron testified that the capitalized vacation pay accrual should be subtracted from the total vacation pay accrual included in the operating

⁵ Mr. Effron calculated the effect of netting the deferred debit against the accrued vacation pay included in operating reserves, rather than making a separate addition to rate base for the deferred debit. On Schedule DJE-1, Mr. Effron eliminated the deferred debit from rate base and instead offset the deferred debit against the accrued vacation pay included in operating reserves. Mr. Effron then calculated the deferred taxes by multiplying the accrued vacation pay net of the deferred debit by the combined state and federal income tax rate of 41.175%. AG Ex. 2.0 at 4-5; AG Ex. 2.1

reserves prior to the calculation of deferred taxes. This is more than merely a matter of “semantics” because the related deferred income taxes are calculated by applying the relevant tax rate of about 41.175% to the accrued vacation pay included in the operating reserves. AG Ex. 2.0 at 5; AG Ex. 4.0 at 4.

The People urge the Commission to reduce rate base by \$8,945,000 to correctly account for the deferred taxes related to the net vacation pay accruals.

V. OPERATING EXPENSES

A. Overview

B. Potentially Uncontested Issues

- 1. Distribution O&M Expenses**
- 2. Customer-Related O&M Expenses**
- 3. Administrative and General Expense**
- 4. Charitable Contributions**
- 5. Chicago Forward Sponsorship**
- 6. Outside Services Employed**
- 7. Transmission Legal Fees**
- 8. 2012 Merger Expense**
- 9. Uncollectibles Expenses**
- 10. Advertising Expenses**
- 11. Sales and Marketing Expense**
- 12. Depreciation and Amortization Expense**
- 13. Regulatory Asset Amortization**
- 14. Operating Cost Management Efforts**
- 15. Storm Damage Repair Expense**
- 16. Interest Expense**
- 17. Lobbying Expense**
- 18. Gross Revenue Conversion Factor**

C. Potentially Contested Issues

1. Rate Case Expenses

The People support the thorough examination and recommendations for disallowances proposed by Staff witness Richard Bridal related to Appeal and Remand, Attorneys and Expert rate case expense.

a. Appeal & Remand

b. Attorneys

c. Experts

d. Other

Section 9-229 of the Public Utilities Act requires the Commission to specifically assess the justness and reasonableness of the attorney and expert witness fees in the rate case expense being charged to ratepayers. That section of the Act provides:

Consideration of attorney and expert compensation as an expense.
The Commission shall specifically assess the justness and

reasonableness of any amount expended by a public utility to compensate attorneys or technical experts to prepare and litigate a general rate case filing. This issue shall be expressly addressed in the Commission's final order.

220 ILCS 5/9-229. ComEd witness Anastasia O'Brien, an employee of ComEd affiliate Exelon Business Services, presented the Company's evidence related to the justness and reasonableness of the Company's 2012 rate case expense charged by outside legal, expert and rate case expense services. Section 9-229, however, does not limit the Commission's investigation of rate case expense to outside expenses. As shown above, the word "outside" attorney or "outside" technical expert does not appear in Section 9-229.

The fact is that utilities often, if not always, include the cost of in-house or affiliate technical assistance for the preparation and litigation of rate cases in their requested rate case expense. *See, e.g.* ICC Docket No. 11-0280/0281 –*North Shore Gas Co. Peoples Gas Light & Coke Co – Proposed Increase in Rates*, NS-PGL Ex. 39.4, filed October 5, 2011. In ICC Docket No. 11-0561 consol. (*Charmer Water Company – Proposed Increase in Rates*), the Commission specifically disallowed in-house legal expenses that the Commission concluded lacked sufficient detail for a finding of justness and reasonableness. Order of May 22, 2012 at 19-20. In the instant case, Ms. O'Brien confirmed that in-house costs are incurred related to rate case expense preparation. Tr. at 173. Yet, no detail was provided in the record regarding those expenses.

To the extent that any in-house/affiliate attorney or technical expert time is separated from the test year affiliate expense and charged to rate case expense, the documentation required under Section 9-229 should be provided in formula rate cases. Given ComEd's failure to provide the same kind of evidentiary detail provided for outside rate case expense, the People argue that costs included in the proposed revenue requirement tied to in-house rate case expense should be excluded from the rates set in this proceeding. In addition, the People believe that the Company should be instructed to provide specific evidence in the next formula rate case on the alleged reasonableness of these in-house fees.

This would be consistent with the Commission's decision in ICC Docket No. 11-0561, and eliminate any unwarranted distinction between internal and external rate case expenses.

2. Incentive Compensation Program Expenses

a. Long-Term Performance Share Awards Program ("LTPSAP")

The People note that they presented a well-reasoned adjustment to the Company's proposed Incentive Compensation Expenses⁶ that excludes all test year expenses incurred by ComEd associated with its new Long-Term Performance Share Award Program ("LTPSAP").⁷ The record evidence in this docket supports the People's adjustment, and Staff is in agreement, that 100 percent of expenses related to LTPSAP should be excluded.

⁶ AG Exhibit 1.3, page 4

⁷ ComEd Ex. 3.0, pages 41-43 and ComEd Ex. 4.0, pages 30-34.

The People argue that the expenses should be disallowed in their entirety because the LTPSAP fails to meet statutory requirements for the recovery of incentive compensation costs. First, section 16-108.5(c)(4)(A) of the Act requires a plan to be based on “achievement of operational metrics.” 202 ILCS 16-108.5(c)(4)(A). The design of ComEd’s LTPSAP, however, does not directly tie employee payouts to ComEd-specific goals in these allowable areas. AG Ex. 1.0 at 31. In order to recover expenses related to incentive compensation under the Act, the Company must present evidence that employee compensation under the plan is based on metrics including those “related to budget controls, outage duration and frequency, safety, customer service, efficiency and productivity, and environmental compliance.” 202 ILCS 16-108.5(c)(4)(A). In this docket, the record evidence demonstrates the contrary.

The People note that the Plan documents reveal that, in order to even participate in the plan, an employee must be one of a select group of executives approved by the Compensation Committee of the Exelon Board of Directors. AG Ex. 1.0 at 31. Second, the LTPSAP does not directly or specifically tie any portion of awards under the Plan to ComEd’s operational performance. Rather, the awards are tied to the performance of the larger parent Exelon. ComEd Ex. 3.07, at 9-11. Therefore, the People argue that the Commission should reject recovery of 100 percent of expenses associated with LTPSAP because it fails to meet the threshold criteria of the Act where it does not foresee achievement of ComEd-specific metrics in order to reward its employees.⁸

The Company has not carried its burden of demonstrating these Plan expenses should be included in rates. As noted by AG witness Mr. Brosch, his investigation revealed nothing in the record that would describe a method for *how* Exelon’s Compensation Committee could choose to weight the performance measures for any or all of the Exelon entities, including ComEd. AG Ex. 1.0 at 32-33. In fact, the Company admits there is no link⁹ and it has failed to present any explanation for the outright omission of ComEd from the metrics of its parent’s plan. Company witness Mr. Trpik testified that, “Awards under LTPSAP are based on performance by ComEd and the other businesses in the Exelon corporate family in six areas that support long-term growth and value...”¹⁰ The Company’s own documents (ComEd Ex. 3.07, page 10) demonstrate that compensation under the LTPSAP is linked only to the performance of the parent company and not ComEd’s own operational performance.

In their Initial Brief, the People demonstrated that the Exelon Compensation Committee must consider Exelon Total Shareholder Return (“TSR”). ComEd Ex. 3.07, page 10. According to Mr. Brosch’s analysis, the ultimate effect of considering TSR is that it “tends to subordinate operational performance within ComEd and the other Exelon businesses to the overall earnings and shareholder returns of the consolidated Exelon entity.” AG Ex. 1.0 at 34. Evidence put in to the record by the People demonstrates that discrete performance cycle targets and results at

⁸ See AG Exhibit 1.0, 31:709-34:790.

⁹ See AG Ex. 1.0 at 33, citing the Company’s response to Staff data request RWB 3.04, where ComEd states, “The LTPSAP target awards are contingent upon the Compensation Committee of the Board of Directors (the “Committee”) qualitative assessment of Exelon’s performance in the six (6) listed goal areas that support the long-term growth and value of the Company, outlined in ComEd Ex. 3.07, Page 9 of 16.” Additionally, in response to Staff data request RWB 10.04, ComEd states, “There are no direct payout percentages associated to each goal.” AG Ex. 1.0 at 33.

¹⁰ ComEd Ex. 4.0, page 31, line 650.

ComEd appear to be assigned only modest weight in determining payouts, and then only after such results are combined with other Exelon business units' results. AG Exhibit 1.9. The Company's own responses indicate that ComEd's operational performance was not a significant driver of LTPSAP incurred expenses and also fail to provide a translation of performance measures into payout amounts. AG Exhibit 1.9.

The People also note that Exelon's performance drives this discretionary compensation: Exelon's compensation committee assesses "Exelon's performance in six goal areas," only one of which is Operational Excellence. AG Ex. 1.0 at 32 (emphasis added). Even the operational excellence goal blends together the performance of multiple Exelon entities. The other considerations under the Plan include consideration of the TSR as a qualitative factor; review of *Exelon's* annual performance based on the sum of every participants' target (determined by the Committee); and the possible adjustment of an individual executive's performance (either up or down) at the discretion of the Exelon Committee. *Id.* However, what is explicitly lacking from the list of criteria to be considered by the Exelon Compensation Committee is any direct tie between expenses incurred by ComEd for LTPSAP to measures of performance that are limited to ComEd operational issues. Instead, the performance metrics are defined for the combined Exelon business units, with overall payouts tempered by Total Shareholder Return. AG Ex. 3.0 at 30.

Finally, the People requested additional information and specific calculations in order to most accurately determine whether ComEd performance was, in any way, linked to the compensation payouts in LTPSAP. In its response to data request AG 6.05, ComEd confirmed that the overall payout decision under the LTPSAP is conditioned upon Exelon's Total Shareholder Return ("TSR") which causes the entire cost of this compensation plan to be fundamentally determined by Exelon consolidated financial, rather than operational metrics. *See* AG Exhibit 3.3. This TSR analysis is said to be a "qualitative factor" that is evaluated and determined by Exelon's Compensation Committee without regard to operational performance within ComEd or other individual Exelon business units.

For all of these reasons, the People support removing all of ComEd 2012 LTPSAP expenses in the calculation of customer rates.

3. Employee Stock Purchase Plan ("ESPP")

ComEd included in the cost of delivery service both the discount expense associated with its offering to employees of the purchase of Exelon stock through an Employee Stock Purchase Plan ("ESPP") at a discount from market prices through payroll deductions and tax-related expenses. The People's well-supported adjustment, presented by AG witness Mr. Brosch in his testimony, removes certain Administrative & General expenses associated with the stock discount program and income tax expenses assigned to ComEd by Exelon, its parent company and should be adopted by the Commission, as discussed below.

a. Stock Price Issue

Under the discounted ESPP stock pricing arrangement, ComEd subsidizes and records a discount expense that exposes its ratepayers to significant program expenses arising from the ESPP share price discount. AG Ex. 3.0 at 25. Citing to the Act, the Commission ruled in Docket No. 11-0721 that stock-based incentive compensation arrangements should generally not be included in ComEd's revenue requirement. 220 ILCS 5/16-108.5(c)(4)(A).

Similarly, in this docket, ComEd's ESPP is a stock-based compensation arrangement. As Mr. Brosch noted in his testimony, a stock-based compensation agreement would directly tie the value of benefits received by employees to the earnings and financial performance of Exelon, as reflected in stock prices, rather than achievement of the statutory criteria referenced by the Commission in its Order. AG Ex. 1.0 at 28. According to the ESPP Prospectus, the stated purpose of the ESPP, "is to provide an added incentive for eligible employees of the Company and its participating subsidiaries (the "Participating Companies") *to promote Exelon's best interests* by permitting them to purchase shares of Exelon Corporation common stock, no par value ("Common Stock"), at below-market prices through payroll deduction."¹¹ (Emphasis added.)

The Company argues that the ESPP should somehow be distinguished from the Company's other stock-based compensation arrangements – all of which have been disallowed by the Commission. According to the Company, the ESPP is a fringe benefit plan and not an incentive compensation plan. Therefore, cost recovery for the ESPP should not be evaluated pursuant to the criteria set forth in Section 16-108.5(c)(4)(A).¹² Also according to the Company, the stated purpose of the plan, to "provide an added incentive" for employees "to promote Exelon's best interests" by permitting them to purchase stock, does not make the ESPP an incentive compensation plan.¹³

As the Commission has previously noted, stock-based incentive compensation plans are treated differently than fringe benefit plans. As demonstrated above, and as Mr. Brosch testified, the mere functioning of this plan demonstrates that it is *not* simply a fringe benefit plan. The functioning of the discount plan both increases ComEd's A&G expenses and impacts the delivery service revenue requirement in an amount associated with the fair value of the option on the purchased stock. AG Ex. 3.0 at 29. At the same time, however, the plan provides a financial incentive for participants in the ESPP to maximize earnings and financial performance of ComEd and Exelon.¹⁴

The People contend that even if the Commission agrees with the Company and does not apply the incentive compensation criteria set forth at Section 16-108.5(c)(4)(A) to determine rate recovery of ESPP expenses, the costs for the ESPP are not reasonably necessary for the provision of regulated delivery services and should be borne by shareholders, not ComEd ratepayers. The Company seeks to raise a distinction that employees must purchase their shares as opposed to being granted the shares as part of a compensation package. The People contend, however, that

¹¹ ComEd Response to AG 4.01, Attachment 1, page 1.

¹² ComEd Ex. 13.0 at 21-22.

¹³ *Id.* at 23.

¹⁴ Additional information regarding how this ComEd expense is determined is provided in the Company's response to data request AG 6.06, which is included within AG Exhibit 3.1.

this distinction is an attempt to distract the Commission from the heart of the issue. The cost of ESPP participation is not fully funded by participating employees. Rather, ComEd subsidizes the purchase of Exelon stock by offering a discounted share price. This subsidization exposes ratepayers to significant program expenses arising from the ESPP share price discount.

ComEd argues that the fact that “the cost of this fringe benefit is somehow influenced by Exelon’s share price is immaterial.”¹⁵ That argument misses the mark, however. First, as established above, the Company’s ESPP is not simply a fringe benefit. Secondly, the share price discounts and other costs of the ESPP that tend to reward only Exelon earnings and financial results should be borne by shareholders and not by ComEd ratepayers.

The People contend that the Company has not met its burden of demonstrating that the ESPP comports with Section 16-108.5(c)(4)(a) for recoverable incentive compensation expense. Rather, ComEd does little more than simply state its belief that its ESPP is not an incentive compensation plan. Employees may purchase Exelon stock through the ESPP at a discount from market value according to a formula that specifies, “The purchase price per share for any purchase period is equal to 90% of the *lesser* of the closing price on the New York Stock Exchange of a share of Common Stock on the first day of the purchase period or the last day of the purchase period on which the Exchange is open.”¹⁶

b. Income tax issue

In addition to the 2012 A&G expense associated with the employee Exelon stock discount, ComEd proposes charging ratepayers for certain income tax expenses arising from the tax treatment of ESPP Exelon stock transactions. AG Ex. 1.0 at 29. ComEd, in its response to data request AG 4.01(b), noted that the income tax expense impacts arising from this plan are directly related to the “intrinsic value” of Exelon’s stock, compared to the “cash received from the sale of stock to employees under the plan.”¹⁷ As noted by Mr. Brosch, “charging ratepayers for income taxes arising from changes in the value of Exelon stock is clearly inconsistent with the intent of the referenced statutory criteria and such income tax expenses should be treated as non-jurisdictional, below-the-line costs.” *Id.*

At some point, participating employees will dispose of their shares. When they choose to do so, these transactions create income tax expense impacts directly tied to the “intrinsic value” of Exelon’s stock. As Mr. Brosch notes, it is unreasonable to burden ratepayers with these incremental income tax expenses. If ESPP participants were paying full price for Exelon shares and not burdening ratepayers with any adverse income tax expense impacts from this program, there would be no ratemaking issue created by the ESPP. However, this is not the case in the test year, as this program exposes ratepayers to significant annual costs for which rate recovery is proposed by ComEd.

Mr. Brosch noted in his rebuttal testimony that “stock-based compensation provides only *financial* performance incentive to participants to maximize the earnings, cash flow and stock price of Exelon stock.” AG Ex. 3.0 at 26. There is no observable link between Exelon share

¹⁵ ComEd Ex. 13.0, 23:489-492.

¹⁶ *Id.* at 4.

¹⁷ See AG Ex. 1.8, ComEd’s response to AG 2.09, part b.

prices and the quality of delivery services being provided in Illinois. Moreover, the Company's responses to discovery requests presented by the People crystallized the People's position that it is not reasonable to include the income tax impacts associated with employee participation in the ESPP in the delivery service revenue requirement.¹⁸

Moreover, Mr. Brosch also uncovered an irregularity in ComEd's bookkeeping related to its income tax adjustment that comes at a further cost to ratepayers. As Mr. Brosch noted, the largest single element of the Company's proposed ESPP-related income tax adjustment¹⁹ is a, "one-time adjustment representing the portion of the IRS qualified amended return ("QAR") adjustment provided to the auditor for the Internal Revenue Service for the period 2006-2010 that is related to the employee disposition of stock..."²⁰ The fact that a portion of the asserted test-year cost for ESPP represents a "one time adjustment" indicates that these prior period adjustments to income taxes are clearly unusual and non-recurring, pre-dating the inception of formula ratemaking for ComEd and should be excluded from cost recovery in formula rates in 2012.

ComEd witness Ms. Brinkman argues that ComEd should fully recover all costs, including O&M and income tax costs associated with the ESPP. This, however, is unfair to ratepayers. Exelon, ComEd's parent company, takes an annual income tax deduction of about \$13-15 million per year. AG Ex. 3.0 at 28. However, due to the consolidated tax filings submitted by the parent company (Tr. at 246, AG Cross Ex. 6), the tax savings from this income tax deduction are not allocated to ComEd or shared with ratepayers. Tr. at 90; AG Cross Ex. 3. Therefore, ratepayers are not only burdened with paying for the costs of discounting shares issued under the ESPP and for income tax expenses arising from the ESPP, but they receive no benefit for the large and recurring income tax deductions taken by the parent entity, on the tax return where dividends paid by Exelon can properly be deducted. The People contend that the Commission should reject this blatantly inconsistent treatment of income tax burdens and benefits arising from employee ownership of Exelon stock.

The Company's position that no adjustment is needed to eliminate this expense seems to ignore the fact that valuable income tax deduction benefits are realized by Exelon on the consolidated group tax return based upon dividends paid on Exelon common stock held in employee benefit accounts. In the three most recently filed Exelon tax returns, these deductions totaled \$15.4 million in 2009, \$15.0 million in 2010 and \$13.6 million in 2011. According to the Company's response to data request AG 6.03, part (c), "...only the corporation paying the dividend is entitled to a deduction. As such, none of Exelon's underlying business units may claim or are entitled to share in Exelon Corporation's tax deduction." This means that when employee ownership of Exelon shares creates an income tax benefit, the Company's position is that the resulting tax savings belongs to Exelon alone and need not be shared with ratepayers in

¹⁸ Details regarding the income tax treatment of the ESPP are set forth in response to data requests AG 2.09, parts (b),(j) and (k) and in AG 4.01. AG Exhibit 1.8.

¹⁹ See AG Ex. 1.0 at line 17 of WP 9

²⁰ See AG Ex. 1.8, Company's response to AG 2.09(k)

Illinois. On the other hand, ComEd proposes that the ESPP costs be treated as fully recoverable from Illinois ratepayers.²¹

Finally, the People argue that ESPP expenses associated with A&G expenses should also be excluded from the determination of the Company's formula rates. For the reasons stated above and in the Commission's Docket No. 11-0721 Order, the costs of employee benefit plans that reward earnings and financial results and are unrelated to the specific statutory criteria included in EIMA should be excluded. Alternatively, the People contend that if the Commission concludes that the ESPP is not an incentive compensation plan and that the Plan expenses are reasonable and can be recovered in rates, only the A&G expenses should be recoverable. The other income tax expense impacts that are driven by Exelon stock price valuations should not be included within the determination of formula rates, particularly where such costs arise from QAR tax return amendments for multiple prior years in connection with IRS audits.

The People also note that while Staff offered no position on this proposed adjustment to operating expenses, Staff also acknowledged that it performed no discovery on this issue and Staff witness Mr. Bridal provided no workpapers or evidence of analysis to the ESPP or its costs (AG Cross Ex. 6; Tr. at 245).

In light of the foregoing, the People urge the Commission to adopt AG witness Brosch's well-reasoned and supported adjustment that removes the income tax expenses associated with Exelon's Employee Stock Purchase Plan that have been assigned to ComEd's ratepayers in the Company's proposed rates.

VII. RECONCILIATION

A. Overview

ComEd and Staff both oppose the well-reasoned adjustment proposed by the AG and IIEC/City/CUB to recognize in the reconciliation under-recovery the Accumulated Deferred Income Taxes realized by the Company during the year being reconciled prior to application of the reconciliation interest rate. As discussed below, both the legal and substantive arguments offered by these parties ignore the language of EIMA and the regular Commission practice of recognizing the cash value of deferred income taxes in the rates paid by utility ratepayers so as not to create unjust and excessive rates.

B. Potential Contested Issues

1. Deferred Income Taxes on Reconciliation Balance

Both AG witness Brosch and IIEC/City of Chicago/CUB witness Michael Gorman took issue with the Company's calculations of interest upon the reconciliation balance – the difference between the revenue requirement actually incurred in 2012 and the revenue requirement that was

²¹ AG Exhibit 3.4 is a copy of the Company's response to data request AG 6.03, which provides more information on this clearly inequitable proposed treatment of the income tax benefits arising from employee ownership of Exelon common stock.

established by the Commission in Docket No. 12-0321. In the instant docket, that reconciliation resulted in an under-recovery, or balance, to which the WACC interest rate is applied. However, AG witnesses Brosch and Effron, as well as IIEC/City/CUB witness Gorman, testified that in order to accurately calculate the reconciliation balance to which the interest rate is applied, the Commission must consider and evaluate the Company's *actual net* incremental investment in such reconciliation balances by recognizing the income taxes that are deferred as a result of the delay in receiving these revenues.²² AG Ex. 1.0 at 18-19; AG Ex. 2.0 at 15-18; IIEC/City/CUB Ex. 1.0 at 4-5.

Because the reconciliation balance is a positive balance, ComEd collected fewer revenues than reflected in the reconciliation balance. Consequently, it paid less in income taxes in 2012 than it would have paid had the higher revenue requirement been in place. As a result, the reconciliation balance must be reduced by the temporary income tax savings associated with the lower revenue level to determine ComEd's *net* cash investment in the reconciliation balance. IIEC/City/CUB Ex. 1.0 at 5; AG Ex. 2.0 at 15. The fact is, ComEd pays income taxes applicable to cash revenues whenever they are collected by the utility. If the recovery of reconciliation surcharge revenue is delayed, then it follows that the payment of related income taxes is also delayed. AG Ex. 1.0 at 18. ComEd witness Brinkman concurred. Tr at 72-74. The deferral in the payment of income taxes is a real cash benefit and should be recognized in the calculation of interest on the reconciliation balances. AG Ex. 1.0 at 16.

In this case, when revenues are under-recovered and reconciliation balances are to be later collected from ratepayers, the Company records the incremental deferred income tax liability associated with the amounts owed by and recoverable from ratepayers. These deferred income tax liabilities *reduce* the incremental capital ComEd actually has invested in the reconciliation balance, because the reconciliation revenues recorded but not recovered in providing service are not currently recognized for income tax purposes. Given the lower after-tax investment required from investors because of these income deferral benefits, the amount of interest properly applied to the reconciliation balance should be reduced accordingly. Interest should only apply to the *net-of-tax* reconciliation balance to reflect the incremental capital investment driven by the over or under-recovery of revenues. This ensures, in this case, that rates are not excessive, or, when reconciliations produce credit balances, insufficient. *Id.* at 18-19.

The need to apply the reconciliation interest to a *net* reconciliation balance was raised by the People in ComEd's Docket No. 11-0721. The Commission's Order in that docket, however, expressed concerns about the completeness of the record, and did not make a definitive ruling. The Commission found that, "ComEd contends that this recommendation does not provide ComEd with cash. AG/AARP provides little information establishing this procedure is within generally accepted accounting procedures, or that it would be of benefit to ComEd or to ratepayers."²³

²² For example, if a cost of \$1,000 is deferred for future recovery from customers but that cost is deductible for income tax purposes as incurred and the combined state and federal income tax rate is 40%. Then the cost will reduce income tax expense by \$400 (40% * \$1,000). The net cash to carry the deferral is \$600 (\$1,000 - \$400), and only this net balance should serve as the basis on which carrying costs are accrued. The same logic is applied when the reconciliation adjustment represents a credit balance owed to customers. AG Ex. 2.0 at 15.

²³ Docket No. 11-0721, Order of May 24, 2012 at 167.

In the instant docket, no party suggests that Mr. Brosch's and Mr. Gorman's proposed adjustments are completely within consistent with GAAP procedures and rules. Under GAAP accounting rules, ComEd is required to record deferred income tax expense because it is able to defer the payment of income taxes while it is awaiting recovery of reconciliation balances. These deferrals of income tax expense have the effect of reducing the amount of capital investment ComEd must make in support of the reconciliation revenue requirement that has not yet been recovered. Full and complete accounting for income tax expenses recognizes that income taxes often impact expenses payable in more than one accounting period. Mr. Brosch testified that the relevant GAAP requirements are stated within Accounting Standards Codification 740 ("ASC 740").²⁴ See also AG Ex. 2.0 at 16.

The People point out that the delayed collection of reconciliation revenues under formula ratemaking creates a "taxable temporary difference" under these rules. This occurs because the utility pays taxes on a revenue actually received in the reconciliation year rather than on the revenue level indicated in the reconciliation balance. Reconciliation revenues are recorded as per book revenues in the reconciliation year (either as excess or deficiency revenues) while such revenues will not become income taxable until the year they are approved by the Commission and charged or credited to ratepayers. ComEd concurs that deferred income taxes must be recorded on its books in accordance with GAAP Accounting Standards Codification 740, as shown in AG Ex. 1.7 (attached to Mr. Brosch's Direct testimony).

The evidence reveals that there are deferred income tax effects directly attributable to the reconciliation balance. ComEd did not actually pay income taxes in 2012 for revenues it did not collect in 2012 but will collect in 2014. Therefore, ComEd has no interest expense related to those (not-yet-paid) taxes. Tr. at 72-74. Application of interest to only the net of income tax reconciliation balance is consistent with the economic reality that the utility does not pay income tax due to the delay in the recovery of taxable revenues. This reduces the overall interest burden

²⁴

Under ASC 740, there are two primary objectives related to accounting for income taxes:

- a. To recognize the amount of taxes payable or refundable for the current year, and
- b. To recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. AG Ex. 1.0 at 21. Recorded ADIT amounts arise from part (b) of this standard, where recognition is given on the books to the future tax consequences of transactions that are treated differently in financial statements than on tax returns. Deferred tax expense (or benefit) is the change during the year in an entity's deferred tax liabilities and assets. A.S.C. 740-10-30-4. GAAP requires that deferred taxes be determined using the following procedures:
 - a. Identify the types and amounts of existing temporary differences and the nature and amount of each type of operating loss and tax credit carryforward period;
 - b. Measure the total deferred tax liability for taxable temporary differences using the applicable tax rate;
 - c. Measure the total deferred tax asset for deductible temporary differences and operating loss carryforwards using the applicable tax rates;
 - d. Measure deferred tax assets for each type of tax credit carryforward; and
 - e. Reduce deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the deferred tax assets will not be realized. A.S.C. 740-10-30-5.

upon ratepayers by about 40 percent. AG Ex. 1.0 at 20. When a reconciliation balance is a credit balance, offsetting applicable deferred income taxes against the reconciliation balance on which interest is accrued is of benefit to the utility, because the utility is then required to credit customers for interest on only the net source of funds provided by the over-recovery. AG Ex. 2.0 at 17.

Indeed, ComEd's 2012 books show specific amounts of deferred income tax liabilities associated with ComEd's reconciliation balance recognized by the Company. ComEd Ex. 3.02, page 26 is part of the Company's WP 4, which provides a detailed breakdown of 2012 year-end Accumulated Deferred Income Taxes ("ADIT") for each book/tax timing difference. At line 95 of WP 4, ComEd has recorded an ADIT liability captioned "Regulatory (Asset)/Liab: Distribution Formula Rate" in the amount of \$34.077 million for federal income taxes and \$10.22 million for state income taxes. This combined \$44.297 million liability for the expected delayed payment of income taxes on the Company's books is associated with the reconciliation balance that was recorded by ComEd at year-end 2012 as a regulatory asset, representing the corresponding delayed recoverability of reconciliation revenues from customers. AG Ex. 1.0 at 20-21.

Despite this clear recognition of ADIT credit balances reflected on ComEd's books as of December 31, 2012 that are associated with the Distribution Formula Rate reconciliation regulatory asset at that date, ComEd offers several reasons, all of them flawed, as to why ADIT balances should be ignored when the net reconciliation balance is calculated. First, the Company claims that the "established rate formula" defines how reconciliation interest is calculated and how tax effects are determined and does not provide for any netting of the ADIT. ComEd Ex. 13.0 at 9. Second, ComEd claims these ADIT amounts have no "cash impact" and that therefore, no ADIT deduction should occur. Finally, the Company claims that the income tax expense is not lower than it would have as a result of the revenue collection timing difference. *Id.* at 10-11. The People assert that these arguments should be rejected.

These arguments miss the mark for several reasons, the People contend. First, the prohibition on changes to the formula rate tariff in Section 16-108.5(d) states, "The Commission shall not ... have the authority in a proceeding under this subsection (d) to consider or order any changes to the structure or protocols of the performance-based formula rate approved pursuant to subsection (c) of this Section." 220 ILCS 5/16-108.5(d). It is unclear whether the inputs for determining the reconciliation balance to which interest should apply found in Schedule A-4 constitute the "structure or protocols" of the tariff itself. Section 16-108.5(c)(4) specifies the protocols in subsections (A) through (I), and the treatment of income taxes associated with the reconciliation balance is not mentioned. Further, the "formula" itself is found in Schedules A-1 and A-1 Rec. These provisions do not specifically reference the calculation of the reconciliation balance, the application of interest to recognize the effect of accumulated deferred income taxes, and certainly in no way prohibit correction of ComEd's failure to recognize the real benefit it realizes associated with the deferred income taxes when calculating interest on the reconciliation balance to accurately reflect the actual, net of tax reconciliation balance. The People contend that if the Commission rejects the argument that the tariff protocols and structure incorporate more than the FR A-1 and FR A-1REC schedules, the Commission should adopt changes to the "formula rate structure and protocols" in the Commission's investigation of the Amended

Formula Rate Tariff in Docket No. 13-0553 that recognize the real cash flow benefit ComEd receives because it is able to reduce its income tax cash payments in the reconciliation calendar year (i.e. 2012) while it is waiting to collect and pay taxes on the reconciliation revenues in future rates (i.e. 2014).

Second, the reconciliation-related ADIT balances represent the cash flow benefit ComEd receives because it is able to immediately reduce its income tax cash payments while it is waiting to collect and pay taxes on the reconciliation revenues. AG Ex. 3.0 at 15. These, Mr. Brosch notes, are very real cash income tax deferral benefits that must be considered and recognized by the Commission in establishing ComEd's rates. ComEd is allowed under formula ratemaking to earn interest while waiting to collect the accrued reconciliation revenues, while at the same time deferring the payment of income tax expenses on such recoveries. This tax deferral benefit effectively reduces the cost to the Company of the deferral by about 41 percent of the accrued reconciliation revenues. The real incremental cash flow impacts can be more fully understood by considering how ComEd's cash flows would be impacted in 2012 if there was no reconciliation to be collected from ratepayers. *Id.*

In order to demonstrate the tangible benefit ComEd receives in the form of ADIT, Mr. Brosch calculated how much additional cash flow would ComEd have had in hand at the end of 2012 if it had fully recovered its claimed actual revenue requirement in that year, and no reconciliation balance existed to require investor-supplied financing. Using the December 31, 2012 recorded \$132 million reconciliation amount cited by Ms. Brinkman as an estimate of the Company's reconciliation balance for that year, and assuming for discussion purposes that \$132 million of additional revenue was collected by ComEd in 2012 so as to represent full cost recovery for that year, the Company would *not* have an incremental \$132 million of cash flow in hand. Instead, the collection of \$132 million in additional cash revenues would be treated as taxable income, causing the Company to incur about \$54 million in incremental current cash income tax expense. This would leave ComEd with incremental additional cash earnings of only \$78 million after income tax payments. This net amount of income tax amount is the cash flow that ComEd has at stake while awaiting recovery of the reconciliation balance, for which it may incur financing costs. AG Ex. 3.0 at 15-16. Interest should only be applied to this net cash flow amount.

ComEd witness Brinkman asserts that it has "incurred carrying costs on the full 2012 reconciliation balance" because it did not receive the revenues in 2012 and will not receive them until 2014. ComEd Ex. 13.0 at 11. But this is simply an incomplete analysis. While it is correct that revenues have not yet been received in cash to recover the reconciliation balance, an equally important consideration is how this delayed recovery of cash revenues has impacted the Company's overall post-tax cash flows, Mr. Brosch notes. AG Ex. 3.0 at 16. The carrying costs ComEd has incurred while waiting for reconciliation recovery relate only to its lost cash earnings in 2012, after cash income tax deferral benefits are considered -- carrying costs are not incurred "on the full 2012 reconciliation balance" as suggested by Ms. Brinkman because there are no carrying costs for costs that are not yet paid. Whether a utility has under-recovered its overall cost of service according to reconciliation calculations (and has recorded a regulatory asset for the amounts to later be collected from customers), or has over-recovered its overall cost of service according to reconciliation calculations (and has recorded a regulatory liability for the

amounts to later be returned to customers), the utility is required in both instances under GAAP to record either a regulatory asset or liability, as well as an offsetting ADIT amount, to recognize the fact that regulatory asset/liability entries do not result in immediately taxable revenues until they reverse and revenues are actually charged/credited to customers in future periods. *Id.* at 16-17.

Moreover, the People explained, reconciliation revenue is added into the utility's earnings by the recording of the regulatory asset, but these accrued revenues are not reported on the utility's tax return because of the delay in the receipt of revenues, represents a book/tax timing difference for which ADIT must be recorded under GAAP. When the accrued reconciliation revenues are later collected in cash from ratepayers through the reconciliation process, the regulatory asset balance is gradually reversed and the offsetting ADIT credit balance is also gradually reversed as the Company's cash income subject to tax is increased. The reversal of the regulatory asset removes from the income statement the higher cash revenues being collected during the recovery period, recognizing that the full amount owed by customers was previously recorded as accrued book revenues in the year it was "earned". The corresponding reversal of the offsetting credit ADIT balance accounts for the fact that income taxes that were previously deferred will become currently payable when the additional cash revenues are collected from customers to recover the reconciliation balance. AG Ex. 3.0 at 18.

ComEd witness Brinkman's assertion that "the deferred tax expense has not been reflected in customer rates, ComEd has not had access to non-investor supplied funds" and that no ADIT should be reflected in the calculation of the reconciliation balance, is nothing less than misleading. While it is correct that ComEd's income tax payments have been deferred until the future periods when taxable revenues representing reconciliation recoveries will be received in cash, it is potentially quite misleading to then state that, "deferred tax expense has not been reflected in customer rates," as if this means such tax deferral benefits should be ignored. The reality is that application of interest to the reconciliation balance represents compensation to ComEd for its foregone cash flows, but the cash flow amounts actually foregone by the Company are not the gross amounts of reconciliation revenues, but instead the net of income tax amounts of lost cash earnings. It is this net amount that must be reflected in the calculation of the reconciliation balance owed by ratepayers. *Id.* at 19-20.

Ms. Brinkman's claim that the ADIT attributable to plant (and the tax benefits associated with that deferral) are different than ADIT realized on a reconciliation balance likewise misses the mark. ComEd Ex. 13.0 at 11. AG witness Brosch pointed out that ComEd is required to defer and amortize over five years the expenses it incurs in excess of \$10 million for major storm event restoration efforts. *See* ComEd Ex. 3.02 at 86. These storm expenses are currently deductible for income tax purposes when paid out by ComEd, even though revenue recovery for such expenses is extended over five years. To recognize its entitlement to delayed recovery of such revenues, ComEd records a regulatory asset that is comparable to the reconciliation regulatory asset in representing a claim for future rate recovery. AG Ex. 3.0 at 21.

The Company also records ADIT amounts to recognize the related book/tax timing difference arising from the immediate tax deferrals for storm restoration expense that are immediately deductible, when the related book expenses are being amortized to be recognize the

delayed revenue recovery for such costs. Regarding the delayed recovery of storm restoration expenses, the People note that ComEd has included all of these credit ADIT balances as 100% delivery service to reduce rate base, offsetting the corresponding inclusion of the regulatory asset for deferred storm costs that is also included in rate base. The important point here is that ComEd is being afforded a return on its reconciliation balance, in the form of reconciliation interest, which is analogous to the return on investment being allowed the Company on its deferred storm expense regulatory asset by virtue of rate base inclusion. ComEd has recognized the need to properly match the storm cost regulatory asset with the offsetting ADIT liability balance, by including both amounts in rate base. The same type of matching should also be required for the reconciliation related ADIT balances by offsetting the gross reconciliation balance prior to applying interest on Schedule FR A-4. *Id.* at 21-22.

In terms of correcting ComEd's failure to recognize the deferred taxes, Mr. Brosch testified that ComEd's recorded \$44.3 million credit ADIT balance for the formula ratemaking reconciliation regulatory asset should be deducted from the utility's rate base because this amount is clearly associated 100 percent with delivery service ratemaking at a single point in time, December 31, 2012. However, because the deferred taxes associated with formula rate reconciliation balances are more dynamic and the template used to calculate reconciliation balances is formulistic, a much more precise accounting for reconciliation interest can be achieved by simply restating the monthly reconciliation balances on Schedule FR A-4 to which the interest rate is applied to a net-of-tax equivalent. This more precise accounting assures that interest on the reconciliation balance is only applied to the monthly amount of net investor supplied capital arising from the delayed recovery or return of reconciliation revenues. AG Ex. 1.0 at 23-24.

The People believe that in order to establish just and reasonable rates, modifications to ComEd's Ex. 3.18, Schedule FR A-4, the formula rate spreadsheet template "Reconciliation Computation," are required. First, the "Variance With Collar" appearing at line 1e should be reduced, on new line 1f, by the related incremental deferred income taxes applying the Company's 41.175% composite effective "Income Tax Rate", which is derived on Sch. FR C-4, at line 4. The resulting "Net of Income Tax Variance" appears on new line 1g of Sch. FR A-4. Then, the caption should be changed to read "Weighted Average Cost of Capital" on line 2, in place of ComEd's proposed "Total Revenue Effect of Return." This is the proper percentage interest rate to be applied to the "Net of Income Tax Variance" on line 1g. Lines 3 through 16 of Schedule FR A-4 are then modified to show 1/12 of the Net Variance in each month, so as to allow the calculation of Interest in column (F) to be driven by the Net Variance amounts. The remaining lines 17 through 28 are unchanged, so as to permit the accrual of additional interest to the declining Net Variance balance from line 16 during the subsequent 12-month recovery period.²⁵ A new line 31 is then inserted to remove the Deferred Income Tax offset, so as to provide for full recovery of the reconciliation balance with pretax revenues. These modifications to ComEd Schedule FR A-4 are revealed in AG Ex. 1.3, page 2, attached to the AG Brief as Appendix A.

²⁵ A more complex calculation could be adopted for the recovery year X+2 to recognize the declining balance of ADIT as regulatory asset balances are being amortized and recovered. In the interest of conservatism and administrative simplicity, this portion of the template was not revised.

The net of tax adjustment to this Schedule FR A-4 would appropriately reduce the amounts to be surcharged to customers in this proceeding. The combined effect of applying interest to the net of tax investment in under-recovered revenues and using the required overall rate of return will reduce ComEd's proposed charge of \$181.1 million at line 31 of Schedule FR A-4 to approximately \$163.9 million, as shown in Appendix A, page 2.

This issue, it should be noted, grows in significance in the establishment of just and reasonable rates given the recent change authorized by P.A. 98-0015 to dramatically increase the interest rate applied to the reconciliation balance. When the previous short-term interest rate was applied to the reconciliation balance, the interest accrued on reconciliation adjustments was relatively immaterial, and the difference between the interest on the pre-tax reconciliation adjustment and the after-tax reconciliation adjustment was relatively negligible. No more. Since the passage of P.A. 98-0015, the utilities apply their WACC as the percentage rate used in calculating interest on the reconciliation adjustments. Because WACC interest is so much higher than a short-term interest rate, the interest on the reconciliation adjustment is no longer immaterial. AG Ex. 2.0 at 18. Thus, it is imperative that the Commission properly apply the new interest rate on the net investor-supplied funds, net of the ADIT balances related to the reconciliation adjustment.

In reply, Both ComEd and the Commission Staff further offer a legal argument in opposition to Mr. Brosch's well-supported ADIT reconciliation adjustment. Both argue that because no specific language authorizing an ADIT adjustment is included in Section 16-108.5(d)(1), rules of statutory interpretation that words are not to be read into a statute, and that the plain language of the statute as written must be given effect, preclude Commission adoption of the adjustment. ComEd IB at 61-62; Staff Brief at 49. These arguments fail, however, upon careful analysis.

In fact, the statute allows the utility to collect interest on the reconciled revenue requirement as follows:

Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior year, the charges for the applicable rate year.

220 ILCS 5/16-108.5(d)(1)(emphasis added). As indicated by the highlighted language, the statute directs the Commission to allow interest on the "*over-collection or under-collection* indicated by such reconciliation." 220 ILCS 5/16-108.5(d)(1). This statutory provision does *not* say, as ComEd's and Staff's interpretation suggest, that the interest should be applied to "the reconciliation balance." The reference to the "*over-collection or under-collection*" clearly references the amount that ComEd actually needs to recover its actual costs incurred compared to the revenue requirement established in the prior formula rate docket – not a gross subtraction calculation that does not reflect ComEd's actual costs incurred during the 12-month period being reconciled.

While the statute could have directed the Commission to apply interest to the full reconciliation “balance” – the term ComEd insists on using throughout its testimony and arguments -- it did not. This provision only authorizes interest on the “over-collection or under-collection.” 220 ILCS 5/16-108.5(d)(1). This requires the Commission to determine the actual over- or under-collection, taking into consideration the cash flow effect of the formula rate process. The Commission should apply interest to the utility’s *actual* cash expense to conform to the legislative intent that the reconciliation reflects “the actual cost information for the applicable calendar year.” 220 ILCS 5/16-108.5(d)(1). The utility pays income taxes on the revenues it receives, and the amount of taxes actually paid by the utility in a given calendar year depends on the revenues *actually* received. Thus, regardless of whether the reconciliation revenue requirement is larger or smaller than that in effect during the year, the determination of the actual cash over- or under-collection indicated by the reconciliation will be affected by the timing of the payment of the income tax expense. AG Ex. 1.0 at 24; AG Ex. 2.0 at 15-16; AG Ex. 3.0 at 15.

The payment of income taxes in the year revenues are received by the utility has a substantial effect on the actual cash flow of the utility. In a situation where the utility has under-recovered its reconciled revenue requirement, which is the opposite of AIC’s present circumstance, Mr. Effron described how the non- payment of income taxes (because revenues are not yet received) reduces the cash needed to fund an under- or over-collection as follows:

For example, if a cost of \$1,000 is deferred for future recovery from customers but that cost is deductible for income tax purposes as incurred and the combined income tax rate is 40%, then the cost will reduce income tax expense by \$400 (40% * \$1,000). The net cash to carry the deferral is \$600 (\$1,000 - \$400), and only this net balance should serve as the basis on which carrying costs are accrued. The same logic applies when the reconciliation adjustment represents a credit balance owed to customers.

AG Ex. 2.0 at 15. In other words, if the reconciliation formula shows that the utility under-collected revenues of \$1,000 in 2012, it will not pay the associated taxes until those revenues are received from consumers in 2014, reducing the cash needed in the reconciliation year, e.g. 2012 to fund the \$1,000 deficit by the tax rate, e.g. 40%. If the utility over collected the \$1000 in revenue from ratepayers in 2012, it would have realized only \$600 in net cash after tax. Company witness Brinkman confirmed a similar hypothetical on cross-examination. Tr. at 72-76. The utility should not receive interest to compensate it for the payment of taxes in 2012 when those taxes will not be paid until the utility receives the under-collected revenues in 2014.

For its part, Staff asserts that, without explanation, that the phrase “[a]ny over-collection or under-collection” in Section 16-108.5(d)(1) refers to the whole reconciliation balance and not some derivative thereof, again citing the argument that there is no specific reference in the statute for ADIT recognition. Staff IB at 49. This argument ignores the other provisions of EIMA, which support the regular recognition of ADIT that occurs in every Commission rate order.

For example, rules of statutory interpretation require that statutes be construed as a whole, with each provision evaluated in connection with every other section. *People ex rel. Dept. of Public Aid v. Smith*, 212 Ill.2d 3898, 404(2004). The formula rate law consistently

recognizes and incorporates Commission authority to review costs and accounting treatment and to apply Commission rules and practices. For example, Section 16-108.5(d)(3) authorizes the Commission:

...to enter upon a hearing concerning the prudence and reasonableness of the costs incurred by the utility to be recovered during the applicable rate year The Commission shall apply the same evidentiary standards, including but not limited to, those concerning the prudence and reasonableness of the costs incurred by the utility... as it would apply in a hearing to review a filing for a general increase in rates under Article IX of this Act.

220 ILCS 5/16-108.5(d)(3); see also *Id.* at 16-108.5(c)(1) & (6). The recognition of the effect of deferred taxes is a well-established regulatory practice. For example, electric utilities must include a schedule of ADIT (accumulated deferred income taxes) in rate case filings, 83 Ill. Admin. Code 288.2080 (Sch. B-9), and all jurisdictional amounts of recorded ADIT credit and debit balances are regularly included- in rate base.

In ComEd's initial formula rate case, an adjustment to rate base was made to recognize ADIT for ComEd's Supplemental Executive Retirement Plan ("SERP"), ComEd's 401(k) matching plan and accrued vacation pay. Docket No. 11-0721, Order of May 29, 2013 at 5, 69. These issues all involved rate base assets that earn a return, and the ADIT balance associated with the asset was necessarily included in rate base to achieve the required consistency. Under the formula rate law, the under- or over-collection indicated by the reconciliation is not included as a rate base item, but the utility can recover interest at a rate equal to the weighted average cost of capital. In order to be consistent with standard regulatory practice that "matches" ADIT elements to the associated assets included in rate base, the effect of deferred taxes on the under- or over-collection indicated by the reconciliation balance subject to interest must be recognized.

The People urge adoption of Mr. Brosch's recommended adjustment to the calculation of reconciliation interest to ensure the correct calculation of the "under-collection" referenced in Section 16-1-08.5(d)(1), and to ensure that ratepayers do not pay excessive rates.

2. WACC Gross-Up

Section 16-108.5(d) of the Act lays out the terms of the reconciliation process under formula rate regulation, as well as the rate of interest to be applied to any reconciliation balance or credit calculated in the annual formula rate update proceeding. Section 16-108.5(d)(1) of the Act, as amended by P.A. 98-0015, now requires that "Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, *with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior rate year*, the charges for the applicable rate year." 220 ILCS 5/1-108.5(d)(1) (emphasis added). As noted by AG witness Brosch, this change to reflect interest at the utility's weighted average costs of capital ("WACC") represents a significant change from the short term debt-only interest rate that was approved for application to reconciliation balances in the Commission's rate orders in Docket Nos. 11-0721 and 12-0321. AG Ex. 1.0 at 14.

In its calculation of the interest rate to be applied to the reconciliation balance, ComEd applied its WACC and then some. In its tariff sheets, information sheets, and populated formula rate templates filed in its Revised Formula Rate Tariff filed on May 30, 2013, and in its most recent formula rate-related filings, ComEd calculated interest at a rate equal to its WACC *grossed-up for the assumed effect of income taxes*. This is shown using the description “Total Revenue Effect of Return” in ComEd Ex. 3.18, Sch. FR A-4, Ln. 2, and Sch FR D-1, Ln 17-26; and ComEd Ex. 14.01 Sch. FR A-4, Ln. 2, and Sch FR D-1, Ln 17-26. The Company’s asserted weighted average cost of capital is calculated at lines 17-21 of ComEd Ex. 3.18, Schedule FR D-1. This calculation properly combines the weighted costs of equity, long-term debt, short-term debt and credit facility costs, resulting in an overall WACC of 6.91 percent. ComEd, however, calculated and applied a much higher annual interest rate of 9.67 percent to its reconciliation balance.

All of the accountants reviewing ComEd’s calculation of the interest applied to the reconciliation balance, including Staff witness Bridal, AG witness Brosch and IIEC/City/CUB witness Gorman agreed that ComEd’s decision to gross up its WACC for the assumed effect of income taxes is wrong both from an accounting and legal standpoint. Staff Ex.7.0 at 38-39; AG Ex. 1.0 at 13-18; IIEC/City/CUB Ex. 1.0 at 3-4. As noted above, nothing in Section 16-108.5(d) refers to any gross up of the utility WACC when computing the reconciliation balance interest rate. The language of the statute, as noted above, simply references application of the utility WACC as the interest rate applicable to the reconciliation balance and does not permit the use of the much higher “Total Revenue Effect of Return” now being proposed by ComEd.

ComEd explains its unorthodox gross up methodology by arguing that “the revenue ComEd receives is subject to income tax”, and “[i]f the gross revenue conversion factor is not applied to the after tax cost of capital, ComEd would not actually recover its allowed cost of capital on the reconciliation balance as provided for in PA 98-0115. The Company argues that this is the same principle that applies to the income tax gross-up that is applied to ComEd’s after tax return on rate base (See ComEd Ex. 3.18, Sch FR A-1, lines 17 and 18).” AG Ex. 1.0 at 15, citing ComEd response to AG data request 4.05(b).

This interpretation of how to apply interest to the reconciliation over- or –under-recovery is simply wrong, however. As explained by AG witness Brosch, it is neither necessary nor appropriate to apply either of the income tax adjustments ComEd has added to its WACC on Schedule FR D-1 to its calculation of the interest rate to be applied to reconciliation balances. He testified that an interest rate is just that, a percentage value to account for the time value of money. AG Ex. 1.0 at 16. Moreover, if income tax effects or a “Total Revenue Effect of Return,” as ComEd devised, were intended to be part of the reconciliation calculation, the revised statute would have stated this intent rather than simply referring to “interest calculated at a rate equal to the utility’s weighted average cost of capital approved by the Commission.” Adding an income tax expense factor-up in the manner proposed by ComEd overstates the required rate of interest and would charge ratepayers for assumed incremental income taxes on equity return amounts that is neither prescribed within the revised statute nor reflective of expenses that ComEd would incur.

Moreover, Mr. Brosch pointed out that ComEd will *not* actually pay income taxes when it collects “interest” as part of the recovery of the reconciliation balances that are calculated on Schedule FR A-4. If the Company incurs interest expense equal to its weighted average cost of capital when reconciliation balances are being financed, there would be no income tax expense incurred by ComEd because “interest” is income tax deductible. The Company is free to actually finance any changes in the reconciliation balance using any form of capital it desires, including a mix of debt or equity. But Section 16-108.5(d) – both before and after the modification of the statute this past Spring – has never required consideration of the Company’s incurred actual incremental financing costs or incremental income taxes arising from specific financing decisions that may be made by the utility. Instead, Section 16-108.5(d) specifies a rate of interest equal to the utility’s weighted average cost of capital without regard to actual financing decisions made by the utility.

As pointed out by Staff witness Bridal, by definition, the reconciliation balance is the difference between two revenue requirements. Each of those revenue requirements was already grossed-up for income tax that was either expected to be paid or actually paid by the utility. Thus, the resulting reconciliation balance itself is already grossed-up for taxes. As such, no additional adjustment for taxes is necessary to the WACC interest rate. Staff Ex. 7.0 at 39. Mr. Bridal also noted that to the best of his knowledge, in all of the Commission’s reconciliation proceeding orders, including, but not limited to, Purchased Gas Adjustments, Fuel Adjustment Clauses, Purchased Water Surcharges, and Water/Sewer Qualified Infrastructure Plant Surcharges (“QIPS”), the Commission has not and does not gross-up the interest rate applied to the reconciliation balance for the effect of income taxes. *Id.* at 39-40.

Importantly, in its original formula rate filings in Docket No. 11-0721 and 12-0321, ComEd did *not* gross-up its proposed WACC interest rate (in Docket No. 11-0721) nor the approved short-term debt interest rate included within Docket No. 12-0321 formula rate protocols. Tr. at 57. The first time the additional gross-up steps appeared was in ComEd’s Revised Formula Rate Tariff filed on May 30, 2013. Adjusting the interest rate for the purported impact of income taxes was never mentioned in any of the testimonies of ComEd witnesses Hemphill or Kathryn Houtsma in Docket No. 11-0721, nor in Docket No. 12-0321. In fact, ComEd admitted in response to an AG data request that it did not consider such a gross-up to the WACC interest rate for the purported impact of income taxes until after Public Act 98-0015 became law. *See* AG Cross Ex. 1.; Tr. at 57. ComEd had no explanation as to why it grossed up the reconciliation balance interest calculation for the first time in its May 30th Revised Formula Rate Tariff filing. AG Cross Ex. 1; Tr. at 59-60. In addition, the Company could identify no change in law that has occurred since the 11-0721 and 12-0321 dockets that would justify the gross up methodology ComEd has applied. Tr. at 61.

Just as significant is the fact that Ameren Illinois Company (“AIC”) did *not* gross up its calculation of the WACC reconciliation interest rate in its revised formula rate tariffs filed after the passage of P.A. 98-0015 – notwithstanding ComEd witness Brinkman’s claims that “every other utility” grosses up the cost of equity for income taxes.²⁶ Ameren proposes, in its formula rate calculations, to apply a “Monthly Interest Rate” of 0.6803% to its reconciliation balance,

²⁶ ComEd Ex. 17.0 at 8. Ms. Brinkman later acknowledged during cross-examination that she was “not aware that they did” gross up the interest rate calculation as ComEd did. Tr. at 63.

“Variance With Collar” amount, as calculated on Ameren Ex. 1.3R at Sch. FR A-4, lines 3 and 4. This percentage represents 1/12 of the Company’s calculated Weighted Average Cost of Capital that is calculated at Sch. FR D-1 and that appears at line 29 in column D. Thus, AIC is proposing that the revenue requirement difference arising from the EIMA reconciliation process, whether positive or negative, be allowed to earn a percentage interest rate equivalent to the Company’s calculated overall cost of capital, as required in P.A. 98-0015, with no income tax factor-up of the type proposed by ComEd. *See* AG Ex. 1.6, attached to Mr. Brosch’s Direct testimony.

In response to AG witness Brosch’s removal of the ComEd gross up of the WACC interest rate, the Company argues, first, that the gross up methodology was approved by the Commission on June 5, 2013, as part of the Company’s Revised Formula Rate Tariff filed after the passage of P.A. 98-0015, and cannot be changed in this proceeding. ComEd Ex. 13.0 at 8. Second, ComEd claims that the “interest rate is used to define a cost, not earnings”, and that income tax impacts must be considered. Third, ComEd claims that the gross up is appropriate because the revenue that ComEd receives for the interest on the reconciliation balance is subject to income taxes, and without recognition of this, “ComEd would not recover or refund its carrying costs related to the reconciliation....” *Id.* The People contend that each of these arguments misses the mark.

First, notwithstanding the prohibition on changes to the formula rate tariff “structure or protocols” in annual formula rate update dockets pursuant to Section 16-108.5(d), ComEd’s method of grossing up the WACC interest rate applied to the reconciliation balance in fact violates Section 16-108(d), which simply states, “Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility’s weighted average cost of capital approved by the Commission for the prior rate year, the charges for the applicable rate year.” 220 ILCS 5/16-108.5(d). The Commission’s investigation of the rates and protocols that were approved on June 5, 2013 in Docket No. 13-0386 is pending. In the meantime, the Commission should recognize that this change is unauthorized, inappropriately increases the interest charges by about 50%, and unfairly increases customer rates.

In addition, it is unclear whether the details deep in Schedules FR D-1 and A-4 constitute the “structure or protocols” of the tariff itself. Section 16-108.5(c)(4) specifies the protocols in subsections (A) through (I). The “formula” itself is found in Schedules A-1 and A-1 Rec. These provisions and schedules do not specifically reference the calculation of the reconciliation interest rate. ComEd’s effort to essentially slip under the Commission’s radar an erroneous and inflated interest calculation violates the terms of the law, and the People believe that the Commission has the authority to correct this erroneous calculation in this docket. If the Commission concludes that the tariff protocols and structure incorporate more than the FR A-1 and FR A-1REC schedules and protocols in 16-108.5(c)(4), ComEd’s unauthorized change to the interest calculation to gross the WACC up for taxes should be eliminated in the Commission’s investigation of the Amended Formula Rate Tariff in Docket No. 13-0553.

Second, ComEd witnesses are wrong when they assert that the interest rate to be applied to the reconciliation balance “is used to define a cost, not earnings” and that therefore income tax

impacts must be considered. The utility's WACC, without being factored up for any income tax adjustments, is the statutorily prescribed reconciliation interest rate. When interest expense is incurred by a business at any assumed cost rate, even a rate as high as a utility's WACC, such interest expense is fully deductible in determining taxable income and does not generate any income tax impacts that must be considered. AG Ex. 3.0 at 11. This means that if ComEd incurs interest at the same WACC percentage cost rate that it recovers from ratepayers, the taxable income resulting from incurring and then recovering such interest would be zero. Notably, ComEd has provided no reference in its rebuttal evidence to any legal authority for the Company's premise that it has been authorized to treat some of the reconciliation interest it recovers from ratepayers as if the underlying financing costs are not tax deductible interest costs, but instead are after-tax earnings or income upon which income taxes would be payable. *Id.*

Likewise, ComEd witness Brinkman is just as wrong in justifying the gross up by stating that, "...the revenue that ComEd receives for the interest on the reconciliation balance is subject to income taxes." ComEd Ex. 13.0 at 8. As pointed out by AG witness Brosch, the revenues received to recover "interest on the reconciliation balance" would be taxable, but would also be fully offset by the assumed incurrence of interest expense to finance such investment, which is income-tax deductible.

Finally, Ms. Brinkman's argument that because a utility receives a weighted average cost of capital return on its rate base that is grossed up for taxes, the interest on reconciliation balances should likewise be grossed up is equally specious. The "weighted average cost of capital return on rate base" that is allowed the utility in determining formula revenue requirements is not "interest" but rather reflects a blend of interest cost recovery and an opportunity to earn an authorized level of net income equal to the weighted cost of equity applied to rate base. In contrast, the reconciliation balance is required to earn only an interest allowance and not a rate base return factored up for income tax allowances. ComEd's overall WACC used in ratemaking and applied to rate base is not "interest" as that term is defined for application to the reconciliation over/under collections. It is quite different, as noted above. If the law was intended to allow an overall cost of capital, rather than a rate of interest, the drafters could have permitted just that in the language that was adopted in 98-0015. It did not. We have no idea what costs will actually be incurred by ComEd at the margin to finance the reconciliation, but we know that 98-0015 requires application of "interest" at a rate set equal to the WACC without regard to the sources or actual costs of such financing.

Moreover, ComEd has supplied no legal authority for the Company's premise that it has been authorized to treat some of the reconciliation interest it recovers from ratepayers as if the underlying financing costs are *not* tax deductible interest costs, but instead as after-tax earnings or income allowance upon which income taxes would be payable. It is not reasonable to assume that financing the reconciliation under recovery can be done at no cost and that no borrowed funds would be involved.

Accordingly, the appropriate interest rate to apply to ComEd's reconciliation balance is the Company's weighted average cost of capital, 6.91 percent, without revision for income taxes. Unless adjustments are made to the Company's calculations in Schedule FR D-1, ratepayers will pay excessive interest for alleged income tax expense effects that the Company is not incurring.

The appropriate interest rate is set forth at line 21 of ComEd Exhibits 3.18 and 14.01, Schedule FR D-1.

VIII. ROE COLLAR

A. Overview

As noted in the Introduction of this Brief, the reconciliation balance amount, with interest at a percentage rate equal to the weighted average cost of capital, is added to the new revenue requirement and collected in customer rates that take effect on January 1, 2014. A separate return on equity “collar” adjustment modifies the reconciliation balance amount to ensure that the Company’s rate of return does not exceed or fall below a 50 basis point “collar” above or below the return on equity set in the prior formula rate proceeding. 220 ILCS 5/16-108.5(c)(5). Under the EIMA ROE collar provisions, the value of any return on equity in excess of 50 basis points above the ROE set in the prior formula rate proceeding shall be credited against the reconciliation balance or credit calculated. Likewise, the value of any return on equity in excess of 50 basis points below the previously approved ROE shall be added to the reconciliation balance or credit calculated. *Id.*

At issue in this case is whether ComEd incorporated the appropriate inputs into the calculation of the collar adjustment in order to correctly reflect the actual costs and earnings achieved by the utility for the time period being measured by the collar calculation. A calculation that underestimates the Company’s return on equity results in a smaller collar adjustment and reduction to the net revenue requirement, thus benefitting ComEd shareholders. Correcting this inequity now is critical to ensuring that rates for the next several years of formula ratemaking are set correctly. As discussed below, ComEd’s calculation of the ROE collar adjustment accomplishes just that, to the detriment of ratepayers.

B. Potential contested Issues

1. Rate Base for ROE Collar Calculation

ComEd presented its calculation of the earned return on equity (“ROE”) in 2012 for the purpose of quantifying the ROE collar adjustment at Schedule FR A-3 of ComEd Exhibit 14.01. This methodology was also incorporated into the Company’s May 30, 2013 filing in Docket No. 13-0386. The Company proposes to use the rate base as of the end of the reconciliation year for the purpose of calculating the delivery service common equity balance and fixed cost capital balances. That is, the Company uses the actual rate base as of December 31, 2012, based on the 2012 FERC Form 1 to quantify the balance of common equity used in the ROE computation and the interest and preferred dividends used in the quantification of the net income available for common equity. As noted by AG witness Effron, rather than the end-of-year rate base, the average rate base for the year should be used in the calculation of the earned ROE for the purpose of the collar calculation. AG Ex. 2.0 at 11.

In Commonwealth Edison dockets 11-0721 and 12-0321, and Ameren Dockets 12-0001 and 12-0293, the Commission determined that in order to reflect the actual costs incurred by the utility in the reconciliation year, the formula rate template should use the average rate base for calculating the reconciliation year rev req. *See, e.g.*, Docket 12-0001, Order of September 19, 2012 at 174-175. The Commission also applied the average rate base in calculating the ROE

collar, done on Schedule FR A-3. Docket 12-0321, Order of December 19, 2012 at 4. As AG witness David Effron testified in this docket, “[t]he net income used in the ROE calculation is the income earned over the course of the year, not the annualized net income being earned at the end of the year. To be consistent, the common equity balance used in the denominator of the ROE calculation should be the average balance of common equity over the course of the year.” AG Ex. 2.0 at 11-12.

As noted earlier in this Brief, the General Assembly made several changes to the law governing how the formula rate is administered in PA 98-0015. Specifically, it amended Section 16-108.5(d)(1) which addresses the inputs to the formula rate revenue requirement and how the filing year and the “prior” year are to be reconciled. In describing the reconciliation revenue requirement, provides as follows, with the P.A. 98-0015 changes underlined:

The filing shall also include a reconciliation of the revenue requirement that was in effect for the prior rate year (as set by the cost inputs for the prior rate year) with the actual revenue requirement for the prior rate year (determined using a year-end rate base) that uses amounts reflected in the applicable FERC Form 1 that reports the actual costs for the prior rate year. Any over-collection or under-collection indicated by such reconciliation shall be reflected as a credit against, or recovered as an additional charge...

220 ILCS 5/16-108.5(d)(1). This subsection addresses how the reconciliation revenue requirement is to be calculated. Indeed, the last paragraph of subsection 16-108.5(d)(1) states:

Notwithstanding anything that may be to the contrary, the intent of the reconciliation is to ultimately *reconcile the revenue requirement* reflected in rates for each calendar year, beginning with the calendar year in which the utility files its performance-based formula rate tariff pursuant to subsection (c) of this Section, with what the *revenue requirement determined using a year-end rate base for the applicable calendar year* would have been had the actual cost information for the applicable calendar year been available at the filing date.

220 ILCS 5/16-108.5(d)(1). This section does *not* address the ROE collar computation.

The ROE collar computation is described in a different Subsection: 16-108.5(c)(5). Unlike Subsection 16-108.5(d) which addresses the calculation and treatment of the utility’s expenses and revenue requirement, Subsection 16-108.5(c)(5) addresses the Company’s actual profitability. The ROE collar allows the utility to retain earnings up to 50 basis points over the authorized return, and requires it to accept earnings up to 50 basis points below the authorized return. If the utility’s earnings exceed these bands, it can impose an additional charge (if earnings are more than 50 basis points below the authorized return) or it must credit the difference to consumers (if earnings are more than 50 basis points above the authorized return). When Section 16-108.5(d) was amended this past Spring to specify that the reconciliation revenue requirement should be calculated using an end-of-year rate base, the section describing the ROE collar, Section 16-108.5(c)(5), was not changed to specify the use of an end of year rate

base calculation of the collar adjustment. Under the statutory interpretation rule of *expressio unius est exclusio alterius*, when certain things are enumerated in a statute, that enumeration implies the exclusion of all other things even if there are no negative words of prohibition. *See, People ex rel. Daley v. Grady*, 548 N.E.2d 764, 766 (Ill. Ct. App. 1989). When an act lists things to which it refers, the court may infer that any omissions were intended as exclusions. *Bank of Waukegan v. Kischer*, 246 Ill. App. 3d 616, 620 (1993).

Key factors in determining the utility's historical year ROE are its rate base, its net income, and its capital structure. ComEd's method of calculating the common equity balance for the collar adjustment based on year-end rate base should be rejected because (1) it is based on a change to the FR Schedules that was not authorized by law and (2) it fails to reflect an accurate representation of the actual capital supplied by equity investors to support the Company's rate base over the course of the year for which the ROE is being calculated. ComEd's approach also has the effect of understating the Company's earnings, which results in smaller reductions to revenue requirements through the collar adjustment. As explained by AG witness Effron, because the net income used in the ROE calculation is the income earned over the course of the year, not the annualized net income being earned at the end of the year, the average rate base for the year should be used in the calculation of the earned ROE. AG Ex. 2.0 at 10.

Applying the common equity ratio to the average rate base will produce a dollar balance that correctly represents the actual capital supplied by equity investors to support the Company's rate base over the course of the year for which the ROE is being calculated. To be consistent, the common equity balance used in the denominator of the ROE calculation should be the average balance of common equity over the course of the year. Mr. Effron explained that in times when the common equity balance is growing, using the end of period balance of common equity will understate the actual ROE earned on common equity provided by investors over the course of the year. Likewise, in times when the common equity balance is decreasing, using the end of period balance of common equity will overstate the actual ROE earned on common equity provided by investors over the course of the year. *Id.* at 10-11.

In response to the AG-proposed adjustment, ComEd witnesses argue that (1) altering the calculation of the ROE collar adjustment would require modification of the formula rate tariff protocols, something prohibited under Section 16-108.5(d) of the Act. ComEd Ex. 12.0 at 5; ComEd 13.0 at 6-7. Company witness Brinkman also claims that use of the average rate base in the collar calculation would "create a mismatch" with the required use of year-end capital structures, and would be inappropriate because "[t]he amounts of debt and equity on the financial statements at the end of the year may be different than the amounts carried throughout the year." ComEd Ex. 13.0 at 6, 8. The People contend that these arguments miss the mark, however.

First, as noted elsewhere in this Brief, the prohibition on changes to the formula rate tariff in Section 16-108.5(d) states, "The Commission shall not ... have the authority in a proceeding under this subsection (d) to consider or order any changes to the structure or protocols of the performance-based formula rate approved pursuant to subsection (c) of this Section." 220 ILCS 5/16-108.5(d). On the other hand, when Section 16-108.5(d) was amended this past Spring to specify that the reconciliation revenue requirement should be calculated using an end-of-year rate base, the section describing the ROE collar, Section 16-108.5(c)(5), was not changed to specify the use of an end of year rate base calculation of the collar adjustment.

Notwithstanding the new requirement to use the year-end rate base in the reconciliation adjustment, the continuing use of the average rate base in the ROE collar calculation is necessary to accurately measure the ROE earned based on the actual equity investment over the course of the year. Also, as noted earlier in this Brief, whether the protocols for the performance-based formula rates, however, include the ROE collar calculation is subject to debate. The People believe that the Commission has the authority to make the change in this docket. If the Commission, however, rejects the argument that the tariff protocols and structure incorporates more than the FR A-1 and FR A-IREC schedules, the modification to the collar calculation to reflect an average rate base should be adopted in the Commission's investigation of the Amended Formula Rate Tariff in Docket No. 13-0553.

As for Ms. Brinkman's "mismatch" claim, there is no more of a mismatch using the average rate base in the collar calculation than is the Company's use of the year-end 2012 capital structure to determine the revenue requirement associated with a rate base that includes 2013 plant additions on ComEd Ex. 14.01, Schedule FR A-1. AG Ex. 4.0 at 7. ComEd's claim that Mr. Effron's use of average year rate base for the ROE collar calculation is inappropriate because "[t]he amounts of debt and equity on the financial statements at the end of the year may be different than the amounts carried throughout the year" is equally specious. As noted by Mr. Effron, the purpose of his proposal is to avoid treating the debt and equity as of the end of the year as if it had been in existence for the whole year for the purpose of the ROE collar calculation. AG Ex. 4.0 at 7-8. Using the year-end capital structure simply means that the common equity ratio will be applied to the average rate base rather than to the year-end rate base. Mr. Effron's approach maintains the year-end relationship between debt and equity, but applies it to the growth of investment over the year.

AG witness Effron provided a simple example of how use of the end of year common equity balance understates the actual earned return on equity when the common equity balance is growing over the course of the year. Assume an investor opened a savings account at the beginning of the year and funded that account by contributing \$100 per month over the course of the year. Assume further that the stated rate of interest on that account is 5%. At the end of the year, the investor will have contributed \$1,200 to the account. However, she will have no claim to interest of \$60, or $5\% * \$1,200$. Rather, the interest earned would be \$30, or $5\% * \$600$, the average balance of the amount contributed for the year. Notwithstanding the stated interest rate of 5%, if one calculated the effective interest rate by dividing \$30 by the year-end \$1,200 amount, the result would be 2.5%. This obviously understates the effective interest rate actually earned by the investor. The same principle applies to the calculation of the earned ROE. If the earned ROE is calculated by dividing the net income by end of year equity balance over the course of a year when the equity investment is growing, the earned ROE will be understated. AG Ex. 1.0 at 13.

AG witness Effron provided a detailed discussion of how the ROE collar computation should be modified to reflect the Company's actual capital supplied by equity investors to support the Company's rate base over the course of the year for which the ROE is being calculated. On Schedule FR A-3, line 1, as filed by the Company on May 30, 2013 in Docket No. 13-0386 and in Docket No. 13-0318, the Company uses the rate base from Schedule FR A-1- REC, line 12 (the reconciliation year-end rate base) in the ROE collar computation. The simplest modification to incorporate the

average rate base into the ROE collar computation would be to include the average of the rate base on Schedule FR B-1, line 28 in the current year filing and the approved rate base on Schedule FR B-1, line 28 in the prior year filing on line 1 of Schedule FR A-3. Thus, the rate base used in the calculation of the 2012 ROE collar computation would be the average of the rate base on Schedule FR B-1, line 28 in the present filing (the rate base as of December 31, 2012) and the rate base on Schedule FR B-1, line 28 as of December 31, 2011 as approved by the Commission. AG Ex. 1.0 at 13-14.

Accordingly, ComEd's average rate base and earned ROE for 2012 is calculated by reflecting the Commission-approved 2011 year-end rate base before projected plant additions of \$6,025,672,000 in ComEd's last formula rate Order (ICC Docket 12-0321) and the reported 2012 year-end rate base of \$6,390,272,000 on Schedule FR A-1 REC, which is reduced to \$6,381,327,000 after Mr. Effron's proposed adjustments. The average rate base for 2012 is \$6,203,500,000. The ROE resulting from this calculation is 9.75% (AG Ex. 2.1, page 1 of 2, Sch. FR A-3-DJE). The ROE collar adjustment on Schedule FR A-1 is \$(25,308,000) (AG Ex. 2.1, page 2 of 2, Sch. DJE-3) as compared to the Company's ROE collar adjustment of \$(6,395,000), with the amounts in parentheses signifying earnings in excess of the collar's range.

Thus, this adjustment results in a reduction to the Net Revenue Requirement on Line 36 of Schedule FR A-1 in Docket No. 13-0318 of \$18,913,000, exclusive of any interest. This calculation is reflected in Mr. Effron's Ex. 2.1, DJE-3. The People urge the Commission to adopt this adjustment in order to ensure that the Company's reported earnings for purpose of the collar calculation are not understated, thereby depriving ratepayers of the requisite collar reduction to the Company's 2014 net revenue requirement.

IX. REVENUES

A. Overview

B. Potentially Uncontested Issues

1. Allocation of PORCB LPCs to Delivery Services

2. Other Revenues

3. Other

C. Potentially Contested Issues

1. Late Payment Revenues related to Transmission

AG witness Brosch proposed two adjustments to ComEd's proposed jurisdictional allocations for certain Late Payment Charge ("LPC") revenues. The first would allocate to the delivery service jurisdiction amounts ComEd wrongly proposed to attribute to its FERC transmission jurisdiction. AG Ex. 1.0 at 9-11; AG Ex. 1.3, page 1. The second proposal concerns allocation of LPC amounts associated with its Purchase Of Receivables Combined Billing ("PORCB") function. There remains disagreement over the People's proposal to credit 100 percent of the Late Payment Charges (LPC) revenues paid in 2012 by ComEd's delivery service (DS) customers when determining the Company's formula-based Net Revenue Requirement.²⁷

²⁷ Mr. Brosch prepared an adjustment calculation to quantify the revised allocation of LPC revenues. AG Exhibit 1.3 at page 1 displays the adjustment for 100 percent DS treatment of Late Payment Charge Revenues. This change would have the effect of increasing jurisdictional "Total Other Revenues" that appear at ComEd Ex. 3.18 and ComEd Ex. 14.01, Schedule FR A-1 at line 22, Schedule FR A-1 REC at line 22 and Schedule FR A-3 at line 14.

As it currently stands, after conceding the PORCB amounts, the Company elects to allocate some of its LPC revenues to its FERC Transmission jurisdiction. Under this current approach, the allocated amounts are credited as revenue when ComEd determines its FERC formula transmission rates.²⁸ The People point out that FERC does not require LPC Revenues to be treated in this manner.²⁹ Rather, all of these revenues are charged to retail DS customers pursuant to an ICC-approved tariff.³⁰ As such, these amounts should be treated as 100 percent DS jurisdictional.

Although, historically, the Company has allocated a portion of these revenues to the FERC jurisdiction, if the Commission re-examines the allocation factors used to jurisdictionally allocate costs, the People recommend ceasing the Company's historically practiced, but inappropriate allocation of Late Payment Revenues to the FERC jurisdiction. The effect of this change would directly reduce the formula revenue requirement for 2012 by approximately \$2.526 million. AG Ex. 1.0 at 9.

The People's adjustment would eliminate the Company's FERC transmission service assignment of LPC revenues.³¹ The Company claims, however, that this jurisdictional allocation issue is not related to allocation method changes being proposed by ComEd related to G&I Plant costs because ComEd's customers necessarily pay for both transmission and distribution services and will receive 'credit' for these LPCs in either the transmission or distribution charges they ultimately pay.³² The Company further argues that the Commission previously rejected Mr. Brosch's proposed adjustment in Docket No. 11-0721.

According to the People, the Company improperly asserts that allocating LPC revenues to either transmission or distribution will not affect customers. ComEd Ex. 14.0 at 28. To the contrary, as demonstrated in Mr. Brosch's testimony, when LPC revenues are credited fully to the DS cost of service determination, as recommended by the People, ComEd's customers will receive full credit through the ratemaking process for such revenues. Alternatively, when over \$2 million of the LPC amounts are unreasonably assigned to ComEd's transmission business, customers who purchase their energy from retail energy suppliers ("RES") have no assurance that they will receive any credit for the portion of LPC revenues that ComEd chose to allocate to its transmission cost of service. This is an unfortunate reality of the competitive marketplace, where RES providers are under no obligation to choose to price their competitive services based solely upon the costs they incur to acquire energy and purchase transmission services. The Company acknowledges that most of the RES providers set a market-based price and that ComEd has no control over the prices that RES providers charge their customers for supply. Tr. at 127. Realistically, given the marketplace and the record evidence in this docket, it becomes

²⁸ ComEd Ex. 3.02, page 90, WP 10, Line 7.

²⁹ For their part, the Company can cite to no specific orders from FERC or another authority directing the Company to assign a portion of the LPC revenues to the FERC jurisdiction. The Company provides more in-depth history into this decision in its response to data request AG 2.06. AG Exhibit 1.4.

³⁰ See ComEd tariff book at ILL. C.C. No. 10, 1st Revised Sheet no. 207. Current ComEd tariffs are available at: <https://www.comed.com/Documents/customer-service/rates-pricing/rates-information/current/Ratebook.pdf>.

³¹ ComEd Ex. 14.0, 28:591-606 and ComEd Ex. 14.01, App 10 at line 7. See also AG Exhibit 1.0, pages 9-11 and AG Exhibit 1.3, page 1, line 1.

³² ComEd Ex. 14.0, 28:591-606.

clear that there is no guarantee that RES providers will pass along to their customers any cost savings arising from ComEd's FERC revenue crediting of LPC charges, and correspondingly lower transmission charges to RES entities.³³

The record evidence also shows that ComEd's approach is inconsistent with how other state utilities are calculating the formula-based revenue requirement for this issue. Ameren Illinois Company, in its formula rate calculations, assigns 100 percent of annual Late Payment Charge revenues as a reduction to the DS revenue requirement, with no attribution to the FERC jurisdiction of such revenues.³⁴ The People contend that there is no record evidence that explains why ComEd should treat the LPC revenues any differently than the Commission treats the DS formula revenue requirements for Ameren.

According to the People, with no ruling on objective evidence in previous dockets, ComEd's attribution of \$2.5 million of LPC revenues to the FERC jurisdiction has not been shown to be factually "correct" in the instant Docket as the Company argues. There are myriad relevant facts supporting the People's proposal. Chief among these are that ComEd charges and collects these revenues pursuant to an ICC-approved tariff, the revenues are collected from Illinois retail customers who are purchasing DS service at ICC-regulated rates, and the revenues are necessary in order to offset the DS revenue requirements so as to fully compensate for the cash working capital cost of customers' delayed remittances. The People also note that there is no FERC order or regulation that ComEd relies upon requiring any allocation of these revenues to the FERC jurisdiction. Furthermore, the other similarly situated large electric utility in Illinois providing both DS and FERC transmission services does not allocate any portion of its Late Payment Charge revenues to its FERC jurisdictional business.

ComEd's tariffs assess its distribution customers the late payment charge as a percentage of the outstanding balance on the bill, irrespective of whether the outstanding balance is supply, delivery, or any other type of charge.³⁵ ComEd customers pay these charges and should be credited the revenues from them in calculating ComEd's revenue requirement. As a delivery company, ComEd bills for functions other than delivery, and assesses late charges on any unpaid balance on a bill, irrespective of whether the underlying charge is for delivery, supply, transmission or other service. In the absence of specific authority for continuing to credit a portion of this revenue to the FERC jurisdiction, and if the Commission accepts ComEd's proposed changes in jurisdictional allocations discussed elsewhere in this Initial Brief, the

³³ In ComEd's response to data request AG 6.04, the Company states, "Mr. Fruehe's understanding is that ComEd's net transmission revenue requirement is initially recovered through a combination of retail customers who elect to purchase ComEd supplied energy, Retail Energy Suppliers ("RESs") who supply energy to retail customers in ComEd's service territory, and generators who utilize ComEd's transmission system. The cost of the energy supplied to retail customers in ComEd's service territory by such RESs and generators includes the cost of transmission service, thus ComEd's retail customers will ultimately bear 100% of ComEd's net transmission service revenue requirement." This response does not indicate that RES pricing is cost-based or that reducing the costs of ComEd's FERC transmission rates by crediting LPC revenues would have any direct impact upon RES energy prices borne by ComEd customers. *See also* Tr. at 124, wherein Mr. Fruehe acknowledges that RES providers set their own prices.

³⁴ *See* Docket No. 12-0001, Ameren Exhibit 1.3R, page 29, where 100 percent of the Line 1 FERC Account 450 Forfeited Discounts revenues of \$11,085 are included in Electric Distribution revenue credits.

³⁵ Commonwealth Edison Co., Ill.C.C. No. 10, 1st Rev. Sheet No. 207.

Commission should credit Illinois customers with 100% of the late payment charge revenues, resulting in a \$2,526,000 increase in ComEd's jurisdictional revenues.

2. Other

X. COST OF SERVICE AND RATE DESIGN

A. Overview

B. Potentially Uncontested Issues

1. Embedded Cost of Service Study

2. Distribution System Loss Factor Study

3. Rider PE – Purchased Electricity

C. Potentially Contested Issues

1. Billing Determinants

ComEd included \$917.8 million of 2013 projected plant additions in its delivery services rate base, offset by an associated increase of \$396.8 million in the balance of accumulated depreciation. AG Ex. 1.0 at 6. The Company has also recognized an increase of \$178.9 million in the balance of accumulated deferred income taxes ("ADIT"), and a decrease of \$14.9 million in the balance of construction work in progress. The net effect is to increase the Company's delivery services rate base by \$327.2 million. *Id.* at 6-7.

One of the components of the total of plant additions estimated for 2013 is for "New Business." Examples are equipment and line extensions to serve new residential or commercial development. The "New Business" component of the 2013 plant in service additions, approximately \$149.3 million, represents facilities to accommodate customer growth. *Id.* at 7.

AG witness Effron testified that the billing determinants used in the calculation of rates necessary to produce the required revenues should be adjusted to reflect customer growth in 2013. AG Ex. 1.0 at 7. In past rate cases, ComEd has recognized post-test year growth in sales and revenues, consistent with its proposed inclusion of New Business plant in its adjustment for post-test year plant additions. The purpose of this adjustment was to match the billing determinants used in the determination of pro forma revenues (under both present and proposed rates) to the plant used to provide service included in rate base. *Id.*

While the pro forma revenues under present rates do not enter directly into the formula rate calculations presented by the Company, the pro forma billing determinants are used to determine the rates necessary to produce the approved net revenue requirement. Thus, it is important to ensure that the billing determinants reflect customer growth so that the revenue streams designed to recover the revenue requirement incorporate are not higher than needed. Mr. Effron's recommendation is adjust the pro forma billing determinants related to customer count (the customer charges and the standard metering service charges) to recognize customer growth in 2013, consistent with the inclusion of New Business plant additions in 2013 in the rate base. *Id.* at 7-8. This adjustment is necessary to properly match the billing determinants used in the determination of pro forma revenues to the plant used to provide service included in rate base. *Id.* at 8.

In response to this proposal, ComEd witness Brinkman argues that it is inappropriate to adjust the historical weather normalized billing determinants for customer growth because the inclusion of New Business plant additions in the pro forma rate base does not ultimately affect the revenues recovered by ComEd. ComEd Ex. 2.0 at 34. While Mr. Effron agreed that because of the reconciliation process, the inclusion of New Business plant additions in the pro forma rate base does not *ultimately* affect the revenues recovered by ComEd, this does not invalidate the adjustment to billing determinants to recognize customer growth.

As Mr. Effron explained, the Company uses the costs from 2012, plus the effect of 2013 plant additions, to establish the initial revenue requirement for 2014. The rates to produce that revenue requirement are then calculated using weather-normalized 2012 billing determinants. The initial 2014 revenue requirement will ultimately be reconciled to the actual 2014 revenue requirement based on actual 2014 costs. But there is no reconciliation of the 2012 billing determinants used to calculate the initial 2014 rates to the actual (or weather normalized) 2014 billing determinants. In substance, what the Company is advocating is that its rates be determined using the actual 2014 revenue requirement and 2012 billing determinants. At the very least, recognizing one year of reasonably expected customer growth partially mitigates this mismatch. AG Ex. 2.0 Rev. at 8-9.

Ms. Brinkman criticizes this point, and claims that this is not correct, because “[i]n this case, for example, the actual revenue requirement ComEd is recovering is for 2012.” ComEd Ex. 13.0 at 33. This critique is invalid, however. As Ms. Brinkman is well aware, in this case, the actual revenue requirement ComEd is recovering is the 2012 revenue requirement *plus projected 2013 plant additions*. Although this may seem to be an overly fine distinction to Ms. Brinkman, it is the addition of the 2013 plant additions to the 2012 rate base that is the basic justification for the adjustment to billing determinants. AF Ex. 4.0 at 5.

ComEd witness Brinkman also offers that if the Commission orders that the historical weather normalized billing determinants used to establish 2014 rates should again be adjusted, then the Commission should adjust those billing determinants both for changes in customers’ use and for changes in the number of customers. ComEd Ex. 2.0 Rev. at 40-41. This argument, however, should be rejected.

First, changes in use per customer are unrelated to New Business plant additions. Second, it is difficult to quantify actual trends in use per customer with any reasonable degree of precision. The data presented by the Company reflect the weather-normalized use per customer; but the weather-normalization process necessarily requires certain assumptions. The use of alternative (but still reasonable) assumptions could well yield differences in the calculated use per customer. The use per customer for a given time frame can also be influenced by temporary, non-recurring conditions other than weather. In fact, using the same time periods used to calculate the customer growth rates (as identified below), the use per residential customer appears to be on an *increasing* trend. However, Mr. Effron does not recommend that the billing determinants be adjusted to reflect increasing use per residential customer. AG Ex. 2.0 at 9.

Ms Brinkman claims that Mr. Effron did “not provide any information to support the alleged increasing use per residential customer, and that statement is not consistent with the

facts.” ComEd Ex. 13.0 at 35. A few comments are in order. First, the Company did not submit any data requests seeking the information on which that testimony was based. However, as stated in his direct testimony, Mr. Effron used the same time periods that were used to calculate the customer growth rates. AG Ex. 4.0 at 6. This information was provided by the Company and is shown on ICC Staff Exhibit 5.0, Attachment 5.1, Page 3.

On AG Exhibit 4.1, Mr. Effron used the information provided by the Company to show the use per residential customer over the same period used to calculate the customer growth rate. As can be seen, the use per residential customer in the first four months of 2013 was 0.82% greater (not allegedly greater) than in the corresponding period of 2012. Based on Ms. Brinkman’s detailed response to Staff witness Mr. Johnson, it is reasonable to believe that Ms. Brinkman was aware of ICC Staff Exhibit 5.0, Attachment 5.1, Page 3 and could have performed the same calculation herself, rather than offering the conclusory statement that increasing use per residential customers “is not consistent with the facts.” Again, Mr. Effron is not recommending that the billing determinants be adjusted to reflect increasing use per residential customer. However, this demonstrates that Mr. Effron’s proposed adjustment for customer growth is not one-sided, as Ms. Brinkman contends.

Ms. Brinkman also observes that the New Business plant additions account for only 0.6% of the Company’s total revenue requirement, but this is irrelevant. The adjustments for customer growth have even less of an effect on the rates necessary to produce the Company’s revenue requirement. That is, only 0.19% of a portion of the billing determinants of the residential class and 0.09% of a portion of the billing determinants of the commercial class are being adjusted to recognize customer growth. AG Ex. 2.0 at 10. If customers should be unconcerned because the effect of New Business plant additions is relatively immaterial, then ComEd should be even less concerned about the adjustments to billing determinants to recognize customer growth.

In sum, Mr. Effron proposes to adjust the pro forma billing determinants that are used to develop the rates necessary to produce the net revenue requirement calculated on Schedule FR A-1. Using the method approved by the Commission in Docket No. 12-0321, the increase in residential customers is 0.19%, and the increase in small commercial and industrial customers is 0.09%. *Id.* In designing the rates to produce the approved revenue requirement, Mr. Effron recommended that the billing determinants used to set rates reflect a 0.19% increase in the number of residential bills and an 0.09% increase in the number of small commercial and industrial bills, in order to reflect estimated annual growth in the number of customers in those classes and to be consistent with the inclusion of 2013 New Business plant additions in rate base.

Ms. Brinkman’s other criticism, that “[t]he first time that charges will be based on the ‘actual 2014 revenue requirement’ is in 2016” (ComEd Ex. 13.0 at 33), is no more valid. The recovery of the actual 2014 revenue requirement in 2016 will include carrying charges at the Company’s weighted average cost of capital. This puts the Company in exactly the same financial and economic position as if the actual 2014 revenue requirement were recovered currently in 2014. That is, although the full recovery does not take place until two years after the costs are incurred, the Company is compensated by the inclusion of carrying charges on the incremental amount recovered, so that the present value of the recovery is the same as if all the costs had been recovered contemporaneously. AG Ex. 4.0 at 5. Under the Company’s proposed

method, the rates to produce those 2014 actual revenues would be based on 2012 billing determinants. A mechanism that mitigates this mismatch is reasonable and does not result in an unjustified loss of revenues to the Company. *Id.* Mr. Effron's reasonable adjustment to adjust the billing determinants used in the calculation of rates necessary to produce the required revenues should be adjusted to reflect customer growth in 2013.

The Company, in this docket, has raised no new or novel arguments that should change the Commission's approach to this issue. The facts are similar in this docket, where the parties are raising nearly identical proposals, the Company is raising nearly identical arguments, and the issues facing the Commission have not fundamentally changed. *See* Docket No. 12-0321, Final Order at 18-28. The Commission has routinely found proposals similar to those offered by Staff and the People in this docket to be reasonable. *See* Docket No. 12-0321, Final Order at 28. The Company has provided no argument that would preclude a similar finding of reasonableness in this docket.

Based on the arguments presented here, the Commission should, therefore, reject the Company's proposed treatment of billing determinants and adopt the treatment proposed by AG witness Mr. Effron and Staff witness Mr. Johnson. AG IB at 64-65; Staff IB at 62.

IX. CONCLUSION

For the foregoing reasons, the People of the State of Illinois request that the Commission issue an order consistent with the positions stated in this Statement of Position.

The People of the State of Illinois

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